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CIS

DIVORCEMENT OF MOTOR FUEL SERVICE STATIONS

HEARINGS

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 326

A BILL TO REQUIRE THE DIVORCEMENT OF MOTOR FUEL SERVICE STATIONS FROM OPERATION BY CERTAIN PRODUCERS AND REFINERS OF MOTOR FUELS, TO CONTROL SALES BY PRODUCERS AND REFINERS OF MOTOR FUELS, AND FOR OTHER PURPOSES

JULY 30 AND OCTOBER 21, 1981

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DIVORCEMENT OF MOTOR FUEL SERVICE STATIONS

THURSDAY, JULY 30, 1981

U.S. Senate,
Committee on the Judiciary,
Washington, D.C.

The committee met, pursuant to notice, at 10:12 a.m., in room 2228, Dirksen Senate Office Building, Senator Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Hatch, East, Grassley, Specter, and Metzenbaum.

Staff present: Vinton DeVane Lide, chief counsel; Marcy Tiffany, antitrust counsel and chief economist; and Peter Chumbris, chief antitrust counsel.

OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The Chairman. The committee will come to order.

As President pro tem, I have to open the Senate every morning. Today it did not open until 10 o'clock, so I was delayed a few minutes.

We will get right down now to this hearing.

The demise of the independent service station which we have witnessed in the 1970's is a source of concern to many in our Nation.

Independent dealers and those threatened by unemployment because of station closings have a personal stake in the survival of the independent service station. Moreover, the health of these enterprises is important to all American citizens who revere the cornerstone of our economic heritage—the small independent business.

Congress has been concerned with the state of competition in the retail gasoline market since the late 1950's. The Committee on the Judiciary itself conducted hearings on this issue, as recently as September 1980.

With the advent of oil decontrol and the recent shift from shortage in gasoline stocks to oversupply, market conditions have substantially changed within the last few months.

It is, of course, vital for this committee to obtain all the relevant facts so that the members may exercise a fully informed judgment in this matter.

Thus, it is necessary and appropriate to continue the inquiry on the state of competition in gasoline retailing as we are doing in this hearing.

We have pending before us S. 326, introduced by Senator Metzenbaum. This bill proposes to extensively restructure the petroleum marketing industry. It is a complex piece of legislation, and it raises a number of serious questions.

It is the responsibility of this committee to fully air all points of view. The number of parties affected by the bill is great, and it is unfortunate that there will not be time to hear from each and every such individual.

We will, however, in this hearing and in the hearing to follow attempt to receive testimony that is representative of their views so that all sides will have an opportunity to be heard.

It is a pleasure for us to have two distinguished members of the House of Representatives with us this morning. We have the Honorable Thomas J. Tauke, a Representative from Iowa, and the Honorable Berkley W. Bedell, a Representative from Iowa.

We would be very pleased to hear from them first, because I know they are very busy and wish to get back to their duties in the House.

Gentlemen, we will be glad to hear from you now.

Also, I wish that a copy of S. 326 be placed in the record at this point.

[The bill follows:]

97TH CONGRESS
1ST SESSION

S. 326

To require the divorcement of motor fuel service stations from operation by certain producers and refiners of motor fuels, to control sales by producers and refiners of motor fuels, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 29 (legislative day, JANUARY 5), 1981

Mr. METZENBAUM introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

To require the divorcement of motor fuel service stations from operation by certain producers and refiners of motor fuels, to control sales by producers and refiners of motor fuels, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Small Business Motor Fuel Marketer Preservation Act of 1981".

DIVORCEMENT OF MOTOR FUEL SERVICE STATIONS; LIMITATION ON RETAIL SALES OF MOTOR FUEL BY REFINERS

SEC. 2. (a)(1) Notwithstanding any other provision of law, it shall be unlawful for any refiner, other than an independent refiner or a small refiner, to operate any motor fuel service station in the United States.

(2)(A) Any interest in any motor fuel service station may be disposed of by a refiner to any person other than the dealer at such station only if such dealer is offered a right of first refusal of an offer made by the refiner to sell such interest.

(B) For purposes of subparagraph (A), a dealer at a motor fuel service station is considered to be offered a right of first refusal of an offer made by the refiner to sell an interest in the station only if—

(i) the refiner gives the dealer, in writing, an exclusive sixty-day option to accept an offer to sell such interest, and

(ii) in any case in which, during such sixty-day period, the dealer makes a counteroffer, in writing, to purchase such interest at a different price, the refiner, during the thirty-day period following the date of the counteroffer—

(I) agrees, in writing, to the counteroffer, or

(II) submits to the dealer, in writing, a revised offer to sell the interest to the dealer at a price to be determined by an independent appraisal meeting the standards prescribed by the Small Business Administration pursuant to subparagraph (C) and undertakes such an appraisal within such time and in such manner as shall be prescribed by the Administration by regulation.

The cost of such appraisal shall be borne equally by the refiner and the dealer.

(C) The Small Business Administration shall prescribe by regulation standards which must be met with respect to an appraisal in order for such appraisal to be considered an independent appraisal for purposes of this paragraph.

(b)(1) Notwithstanding any other provision of law, except as otherwise provided in paragraphs (2) and (3)—

(A) it shall be unlawful for any supplier to sell to any independent wholesale purchaser any type of motor fuel on any day at any point of transfer at any price other than the daily wholesale transfer price for that day (described in paragraph (3)); and

(B) it shall be unlawful for any supplier to sell or to transfer any type of motor fuel on any day at any point of transfer to any person related to the supplier at a price lower than the daily wholesale transfer price for that day (described in paragraph(3)).

(2)(A) Nothing in this subsection shall be construed to prevent differentials in prices of any type of motor fuel from the daily wholesale transfer price for such type of motor fuel which make only due allowance for differences in the cost of manufacture, sale, or delivery of such motor fuel resulting from the differing methods or quantities in which such motor fuel is sold and delivered.

(B) Nothing in this subsection shall be construed to prevent differentials in prices of any type of motor fuel from the daily wholesale transfer price for such type of motor fuel consisting of price reductions offered to independent wholesale purchasers in good faith to meet competing price reductions offered by others to those independent wholesale purchasers.

(C) Nothing in this subsection shall be construed to prevent a refiner from charging a uniform and reasonable surcharge in connection with sales of motor fuel to persons as consideration for the use by such persons of a trademark, trade name, service mark, or other identifying symbol or name and any services associated with such use.

(3) Each supplier shall maintain for each business day a single daily wholesale transfer price for each type of its own motor fuel, which the supplier shall make available to purchasers at all times during such day at each point of transfer

used by the supplier. A supplier's daily wholesale transfer price for any type of motor fuel for any day shall be the price which is charged to the first independent wholesale purchaser of that motor fuel that day. If the supplier's first independent wholesale purchaser of any type of motor fuel on any day does not take title to the product at a point of transfer, the supplier's daily wholesale transfer price for that type of motor fuel shall be calculated by deducting any reasonable and uniform transportation expense which has been allocated to the price charged to that first purchaser for that type of motor fuel.

(c)(1)(A) Notwithstanding any other provision of law, it shall be unlawful for any person to restrain, interfere with, or in any way prevent the purchasing from another, the storing, or the selling of motor fuel by any dealer.

(B) Subparagraph (A) shall not apply with respect to any provision of any contract or agreement to the extent that the provision requires the purchasing of any motor fuel by any dealer exclusively from any refiner or distributor, but only if such provision provides that such dealer may purchase such motor fuel from any other person if such motor fuel is not readily available from such refiner or distributor upon terms and conditions reasonably comparable to those available to the dealer from such other person.

(2) Notwithstanding any other provision of law, it shall be unlawful for any dealer, at a motor fuel service station displaying a trademark, trade name, service mark, or other identifying symbol or name owned by a refiner, to sell motor fuel which is not provided by such refiner without providing reasonable notice at the point of sale to each purchaser of such motor fuel that such motor fuel is not refined by such refiner.

(d)(1) Not later than ninety days after the date of the enactment of this Act, and annually thereafter, each refiner shall provide in writing to the Federal Trade Commission—

(A) the number of gallons of motor fuel sold at motor fuel service stations operated by the refiner during the preceding calendar year by the refiner in the United States,

(B) the number of gallons of motor fuel manufactured during the preceding calendar year by the refiner in the United States,

(C) the number of barrels of crude oil produced during the preceding calendar year by the refiner, and

(D) the number of barrels of crude oil refined during the preceding calendar year by the refiner.

(2) Not later than ninety days after the date of the enactment of this Act each refiner shall provide in writing to

the Federal Trade Commission the information described in paragraph (1) with respect to calendar year 1978.

(3) The Federal Trade Commission shall not require from any person information referred to in the preceding provisions of this subsection to the extent that the Commission is able to obtain such information from agencies or departments of the United States.

(e) For purposes of this section:

(1)(A) The term "producer" means any person who is engaged in the production of crude oil or who owns crude oil when it is produced.

(B) Such term includes any related person with respect to such person.

(2)(A) The term "refiner" means—

(i) any person engaged in the refining of motor fuel, and

(ii) any producer for whom refining of crude oil produced by such producer, or owned by such producer when such crude oil is produced, is performed under contract.

(B) Such term includes, when used in connection with any person described in clause (i) or (ii) of subparagraph (A), any related person with respect to such person.

(3) The term "independent refiner" means a refiner who obtained, directly or indirectly, in calendar year 1978, more than 70 per centum of the refiner's refinery input of domestic and imported crude oil from producers who are not related persons referred to in paragraph (2)(B).

(4) The term "small refiner" means a refiner whose total refinery capacity does not exceed one hundred and seventy-five thousand barrels per day.

(5) The term "supplier" means any person who sells motor fuel to motor fuel service stations or other independent wholesale purchasers.

(6) The term "independent wholesale purchaser" means any purchaser of motor fuel who sells the motor fuel at retail or distributes the motor fuel for sale at retail, but does not include any purchaser related to the person selling the motor fuel to the purchaser.

(7) The term "related person" means, with respect to any other person—

(A) a person who holds a significant ownership interest in such other person;

(B) a person in whom such other person holds a significant ownership interest; and

(C) a person in whom a third person holds a significant ownership interest while holding a significant ownership interest in such other person.

(8) The term "significant ownership interest" means—

(A) with respect to any corporation, the single largest share in value of the outstanding stock of such corporation,

(B) with respect to a partnership, the single largest share in the profits or capital of such partnership, and

(C) with respect to an estate or trust, the single largest share of the beneficial interests in such estate or trust.

For purposes of determining significant ownership interest, an interest owned by or for a corporation, partnership, trust, or estate, or held by a voting trust, shall be considered as owned directly both by itself and proportionately by its shareholders, partners, or beneficiaries, as the case may be.

(9) The term "motor fuel" means gasoline, diesel fuel, alcohol, and any mixture of any of the foregoing, suitable for use as a fuel in self-propelled vehicles designed primarily for use on public streets, roads, and highways.

(10) The term "motor fuel service station" means any facility at which motor fuel is sold at retail.

(11) The term "sell at retail" means to sell to the general public for ultimate consumption.

(12)(A) Except as provided in subparagraph (B), the term "dealer" means a person who occupies as a retailer a motor fuel service station.

(B)(i) When used in subsection (c)(2), the term "dealer" means, with respect to a refiner, a person described in subparagraph (A) who occupies the motor fuel service station under lease or rental agreement with the refiner.

(ii) Notwithstanding clause (i), a person described in such subparagraph shall not be considered a dealer if the lease or rental agreement is with a refiner in connection with whom such person is a related person referred to in paragraph (2)(B).

(13) The term "operate" means, when used in connection with a motor fuel service station, to engage at such station in the business of selling motor fuel at retail through any—

(A) employee,

(B) commissioned agent,

(C) person operating such station pursuant to a contract with a refiner, or

(D) person acting on behalf of the refiner or under the refiner's supervision,

whose duties include the sale of such motor fuel.

(14) The term "basic unit" means, in connection with motor fuel—

(A) a dealer tankwagon or transport load;

(B) a railroad tank car load;

(C) a barge load; and

(D) a pipeline tender.

(15) The term "person" includes one or more individuals, partnerships, associations, corporations, legal representatives, joint-stock companies, trustees and receivers in bankruptcy and reorganization, common law trusts, and any organized group, whether or not incorporated.

(16) The term "United States" means, when used in a geographic sense, the several States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, American Samoa, the Northern Mariana Islands, Guam, the Trust Territory of the Pacific Islands, and any other territory or possession of the United States.

(f)(1) Any person who violates any provision of subsection (a)(1) shall, upon conviction, be punished by a fine of not to exceed $50,000 per month for each motor fuel service station operated during such month in violation of such subsection.

(2) Any person who violates any provision of subsection (a)(2) shall, upon conviction, be punished by a fine not to exceed $50,000 for each such violation.

(3) Any person who sells motor fuel in violation of subsection (b) shall, upon conviction, be punished by a fine not to exceed $10,000 for each such sale.

(4) Any person who violates any provision of subsection (c)(1) shall, upon conviction, be punished by a fine not to exceed $50,000 for each such violation.

(5) Any person who violates any provision of subsection (c)(2) shall, upon conviction, be punished by a fine not to exceed $5,000 for each such violation.

(6) It shall be the duty of the Federal Trade Commission to commence a civil action for appropriate relief, including a permanent or temporary injunction, whenever any person violates any provision of subsection (a), (b), or (c). Any action under this paragraph may be brought in the district court of the United States for the district in which the defendant is located or resides or is doing business, and such court shall have jurisdiction to restrain such violation and to require compliance.

(g)(1) If any person fails to comply with the requirements of this section, any other person directly affected by such failure may maintain a civil action against such person failing to comply with such requirements for damages and appropriate equitable relief, including temporary and permanent injunctive relief. If the plaintiff prevails in any action under this section, the plaintiff shall be entitled to reasonable attorney and expert witness fees to be paid by the defendant, except that in any case in which the court determines that only nominal damages are to be awarded to the plaintiff, the court may, in its discretion, determine not to direct that such fees be paid by the defendant.

(2) Such action may be brought, without regard to the amount in controversy, in the district court of the United States in any judicial district in which the principal place of business of such person is located or in which such person is doing business.

(h) Subsections (a)(1), (b), and (c) of this section shall take effect one year after the date of the enactment of this Act.

REGULATIONS

SEC. 3. (a) The Small Business Administration shall prescribe the initial regulations required by the provisions of section 2 before the end of the one-hundred-and-eighty-day period beginning on the date of the enactment of this Act.

(b)(1) The Federal Trade Commission shall prescribe by regulation the annual date by which the information described in section 3(d)(1) is required to be provided under such section before the end of the sixty-day period beginning on the date of the enactment of this Act.

(2) The Federal Trade Commission shall prescribe any other initial regulations required by the provisions of section 3 before the end of the one-hundred-and-eighty-day period beginning on the date of the enactment of this Act.

STATEMENT OF HON. BERKLEY W. BEDELL, A U.S. REPRESENTATIVE FROM THE STATE OF IOWA

Mr. **Bedell.** Thank you, Mr. Chairman.

As the chief sponsor in the House of the Small Business Motor Fuel Marketer Preservation Act, I am pleased to speak in support of S. 326.

As you know, this legislation is cosponsored by a bipartisan group of 88 Members in the House of Representatives. Congressman Tauke who served with me on my subcommittee in the House last session had a great deal to do with the hearings that we had and what has gone into that bill.

Along with a list of the cosponsors of H.R. 1362, I would like to place in the hearing record, a detailed summary of the bill's key provisions.

The central theme of S. 326 and H.R. 1362 is the fact that we cannot count on the give and take of the normal contract bargaining process to assure equity in the relationships between motor fuel marketers and their suppliers. It seems that when major oil companies negotiate contracts with their marketers, the small business people are expected to give and the oil companies can be expected to take.

The simple truth is that there is no effective bargaining in contract negotiations between major refiners and their dealers. Rent increases, changes in credit terms, changes in delivery policies—the record is loaded with examples of how these changes in contract relationships are offered on a take-it-or-leave-it basis by the oil companies.

It is bad enough that the dealer-refiner relationship closely resembles that which existed between medieval serfs and their lords. The problem is greatly compounded by the increasing volume of direct retail sales by the major integrated oil companies.

This puts major refiners in direct competition with their own major brand dealers.

The volume of sales in refiner direct-operated outlets has more than doubled since 1973. Similar problems are being experienced too by jobbers who are losing commercial accounts to their refiner suppliers.

The State of Maryland has had a retail marketing, a divorcement, law since 1973. It went into effect after the U.S. Supreme Court ruled it constitutional in 1978.

The comptroller of the State of Maryland testified that the Maryland experience has been quite positive. The testimony received shows that Maryland still has gas-and-go stations, high volume super pumpers, and 24-hour service available. It appears that the consumer in Maryland has fared quite well under divorcement.

Of course, this completely contradicts the dire warnings of various spokesmen on behalf of the oil companies. They say that the passage of divorcement legislation would create chaos and raise consumer prices.

The Maryland experience shows these charges to be false.

Mr. Chairman, I would urge you to go south into Maryland. I happen to be a fisherman. I go down there frequently. I buy gasoline at $1.22 per gallon in gas-and-go stations that have major oil company signs out in front. That is less than what I can buy gasoline for in Washington, D.C.—by more than the 2-cent-tax differential. They are open day and night.

Those people who talk about the dire warnings of what is going to happen if this legislation passes should make the 30-minute drive south on Highway 5 to see what is happening in the State of Maryland.

At this point, Mr. Chairman, I would caution you that your committee will hear a lot about the study by the Department of Energy's Office of Competition, released earlier this year.

As an example of the problems we have with the DOE report, I will merely point out that the report was issued in response to a requirement contained in title III of the Petroleum Marketing Practices Act. Title III required the study to include a report of the functional profitability of the integrated oil companies. The report was to be delivered to the Congress by December 1979. Not only was the report delivered 13 months late, but it did not include the required report on functional profitability.

Mr. Chairman, the issue at hand is this. Are we going to assure that the independent marketers of gasoline have an opportunity to compete on fair and equitable terms, or are we going to sit by idly while the ranks of the dealers shrink further and further?

These people are going out of business not because they cannot compete but because they are not allowed to compete. It is very clear to me that if we truly believe that there is and should be a place for the local small businessman in the gasoline retail marketplace, then we must act quickly to give that independent marketer the opportunity to compete on a fair and equal basis.

It is just as clear to me that if we do not do this, the current trends will continue and the situation will get worse. There will be fewer and fewer independent businesses in motor fuel marketing, and the major integrated oil companies will have further consolidated their grip on our economy.

If Congress does not act soon, the ranks of the 100,000 small businesses currently engaged in gasoline marketing will dwindle to a mere handful and be replaced by the seven sisters and their close cousins.

I would like to depart from my prepared remarks for a moment. I have had the opportunity to review the testimony of a witness who will appear before your committee later this morning.

Mr. Robert Campbell will tell you, as will other witnesses testifying against S. 326, that the antitrust laws are sufficient to handle any problem that exists in the gasoline retail marketplace.

I would like to share with this committee parts of the dialog Mr. Tauke and I had with Richard Favretto, then the Acting Assistant Attorney General for Antitrust at the Department of Justice.

We asked Mr. Favretto at the Small Business Energy Subcommittee's hearings on H.R. 1362 if he felt the antitrust laws did indeed apply.

He said, and I quote from the hearing records:

> If there is no dangerous market share or probability of a monopoly marketplace, there would be no difficulty for a refiner to refuse to supply one of its independent dealers. I would concede that the antitrust laws do not apply in all such cases.

By the way, Mr. Chairman, both the FTC and the Justice Department were hard-pressed to point out any recent antitrust suits brought against a major refiner for its action in the gasoline marketplace.

There is another aspect to Mr. Campbell's testimony that greatly disturbs me. It has grave implications—not only for small business motor fuel marketers but for all small businesses as well.

Mr. Campbell says on page 11 of his prepared remarks, and I quote:

> If the integrated major oil company in fact utilizes its retail stations as a means of insuring an outlet for its refined gasoline and is able to earn a profit on its integrated operations, the lower price charged at the retail level is a clear benefit for the consumer. Such subsidization by upstream operations of the integrated major lacks antitrust significance and should be encouraged.

I hope you will think about that statement for a minute, Mr. Chairman.

Mr. Campbell suggests that we should not be concerned. In fact, he says we should encourage large, integrated companies to use their huge size and their profits from different levels of integration to drive out competitors who operate at only one or two levels of the distribution channel.

If this attitude became prevalent in our society, in time there would not be a single small business in operation in our whole economy.

Unfortunately, Mr. Campbell's statement may explain what is happening in the gasoline retail marketplace. The independent marketer is simply overpowered by the huge independent oil company.

Enactment of legislation such as S. 326 would end the tremendous disparity in power between major integrated refiners and their marketers and pave the way for a more equal relationship between parties. Then, I believe, it is clear that the consumer will benefit.

I thank you very much, Mr. Chairman.

The CHAIRMAN. Congressman Bedell, according to your staff analysis, gasoline prices in Maryland were not negatively affected by divorcement. Do you know whether the Maryland divorcement law also included the wholesale pricing provision like the one in S. 326 and H.R. 1362?

Mr. BEDELL. No; it did not, Mr. Chairman.

The CHAIRMAN. Would that make a difference?

Mr. BEDELL. No. I think actually the Maryland divorcement law went further than this bill does. The Maryland divorcement law divorced, as I understand it, all refiners from operating their own stations. This bill eliminates only the major refiners.

The reason we did it in our legislation was that the great disparity in cost comes between those refiners who have large reserves of domestic crude oil which can be pumped at significantly lower prices than the crude oil that is imported. They are in a position, if they wished to do so, in the opinion of many of us on the committee, to use that cost advantage to move it downstream, as I mentioned, to be able to unfairly compete with the dealers and, frankly, even with the smaller independent refiners.

The CHAIRMAN. Congressman Bedell, can you tell us the current status of H.R. 1362 in your subcommittee in the House? Do you anticipate that there will be any significant amendments made to it?

Mr. BEDELL. I do not know, Mr. Chairman. I think we need to be candid and honest.

In the last session, the bill passed unanimously out of our subcommittee and passed the full committee with only one dissenting vote.

I happen to believe that it is important that you have consensus on legislation and that there be general agreement in our committee.

There was an indication of some concern among some of the members. It was my opinion that we should delay consideration until we have had adequate hearings, so that all of the members could be adequately informed of exactly what is happening and what some of the concerns were.

For that reason, we have held it back until we have those additional hearings. I think what we do will be dependent upon how the members of the committee feel after we have had a chance to sufficiently look at the issue.

The CHAIRMAN. Thank you.

I will now call upon Senator Metzenbaum, the author of this bill.

STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. Thank you, Mr. Chairman.

I apologize for being late. I have just been told I am going to have to leave for the floor.

I wanted to thank you particularly for holding these hearings promptly. I want to indicate also that I appreciate the active role that you played last year in connection with this legislation. I am very pleased to see you taking an active role again in seeing that we move forward with the hearings.

Frankly, I believe that something must be done because the situation is getting rougher and rougher for the independent service station dealer.

The dealers are up against the massive power of the oil companies.

If there is one thing which has impressed me since I have been in the U.S. Senate it is that the power of the oil companies is comparable to none else. They can take on the President of the United States, whether he is a Democrat or a Republican. They can take on the Congress of the United States.

Just within the last few days, as if it were not enough, after we gave them $20 billion in windfall profits tax relief, they went over to the House and got $3 billion more from the Ways and Means Committee and then another $20 billion to sweeten it up so that some people would vote for that bill yesterday.

What we find is that these billions of dollars are being used against rather defenseless independent dealers. An oil company can afford to throw on the table as much as it has to in order to squeeze out the independent, and they have not hesitated to do so in the past.

I think it is commendable that Congressman Bedell, Congressman Tauke, and others in the House have seen fit to provide the leadership. I commend all of them because without your strong voices over there, I think it would have been more difficult on this side.

As a matter of fact, the major oil companies now control all aspects of the oil industry—93 percent of the domestically proven crude, 90 percent of the crude oil pipelines, 80 percent of the Nation's refining capacity, and 75 percent of the Nation's finished product pipeline capacity.

The question is really how far does the avarice and greed go before they stop?

If we pass a windfall profits tax bill which is a part of decontrol and a deal is struck, within a year they are back here saying it is not enough.

If the Senate gives them $20 billion, they run to the House Ways and Means Committee and get some more billions. Then they go to the President of the United States, and he throws whatever else is needed on the table in order to buy up votes in the House.

Merely accelerating decontrol by several months, to January 28, 1981, brought oil companies $10 billion in immediate profits and increased the value of their reserves by $170 billion.

Oil companies today have so much money that they have been using their huge cash reserves to move into other areas through acquisitions.

They came to the Congress and said: Give us decontrol. Do not do too much with the windfall profits tax. We need it to produce more oil for the country.

It is unadulterated hokum. What have they done? They have gone out and picked up part of Amax Co. Sohio in my own State has picked up Kennecott for $1.7 billion.

Exxon came before this very committee and told us: We have to buy Reliance Electric Co.; because if we can buy Reliance Electric, we have a motor that is going to save 1 million barrels of oil a day.

They went for it, and they bought Reliance Electric. A year later they said: Sorry, old buddy. The motor does not work. We still have Reliance, and that is your problem.

Now they are trying to control gasoline retailing as well.

The oil companies talk competition and free enterprise, but they are trying to eliminate competition in retailing by driving the independents out.

Between 1972 and 1979, the number of independents has declined by 80,000. The attrition is continuing at the rate of 10 percent per year. At the same time, the majors have doubled sales of gasoline through their own stations.

In Ohio, between 1972 and 1979, the lessee dealer's portion of gasoline sales fell 49 percent, while the refiner-operated portion rose nearly 200 percent.

Independent dealerships are declining because of unfair tactics by major oil companies. For example, they will do almost anything in order to drive the independent out—doubling of rents overnight, abrupt movement from 2-week float to cash on delivery, delays in credit card processing, refusals to provide allocations, and subsidization of refiner-operated outlets.

This is nothing new to the antitrust department, but they are not going to do anything about it. They did not do anything about it under previous Presidents.

As Congressman Bedell has so aptly pointed out, they did not intend to do anything. They certainly will not do anything under the antitrust department that is in place at the moment. This morning they indicate they are even prepared to drop the A.T. & T. case.

With decontrol, the problems are becoming worse—for example, requirements that stations stay open for 24 hours a day and requirements that stations sell arbitrarily high amounts of gasoline.

This bill's approach is a moderate one, especially considering the severity of the dealers' problem. It only precludes oil companies from operating outlets—not owning them. It puts everyone—dealers, wholesalers, and refiners—on an even footing by precluding suppliers from subsidizing their own marketing outlets.

It permits dealers to purchase gasoline from other than their contract supplier, only if their needs cannot be met by that supplier.

I commend you, Mr. Chairman, for holding this early hearing. I hope that the entire committee can act on the legislation soon, and I urge my colleagues to support it.

I apologize to you, Mr. Chairman, as well as to those present that at a very early point I have been called to the floor in connection with the tax bill. Thank you very much.

The CHAIRMAN. The distinguished Senator from North Carolina, Senator East. Do you have an opening statement, Senator?

Senator EAST. I do not, Mr. Chairman.

The CHAIRMAN. Do you have any questions you would like to propound?

Senator EAST. No, sir; I do not.

The CHAIRMAN. Congressman Tauke, we would be very pleased to have you make your statement at this time.

STATEMENT OF HON. THOMAS J. TAUKE, A U.S. REPRESENTATIVE FROM THE STATE OF IOWA

Mr. TAUKE. Thank you, Mr. Chairman.

I appreciate the opportunity that you have given us to appear before this committee of the Senate to talk about this legislation.

Because my colleague from Iowa, Mr. Bedell, did his usual comprehensive and thorough job of explaining the legislation, I would prefer to submit my statement for the record and make a few comments, if that meets with your approval.

The CHAIRMAN. Without objection, your entire statement will be placed in the record, as will the statements of all the witnesses, at the completion of the oral presentations of each panel.

You may proceed to summarize, Mr. Tauke.

Mr. TAUKE. Mr. Chairman, in the interest of time, let me just make a couple of points.

I believe that it is fair to say that when you cut through all of the discussion that we have had over the last 2 years about this legislation, the issue really boils down to one that is quite simple. That is that today we have lessee dealers competing head-on with their own suppliers.

I believe it is very difficult to have a free competitive situation when you have the people who are supplying dealers competing directly with them in the retail marketplace.

I think that unfair advantage is built into the system, and that is the problem that we need to address.

I think if we look at the conditions that govern supplier-dealer relationships, we can see that all of the arrangements are controlled by the supplier. The lease terms are controlled by the supplier, the supply, the amount of the supply and the cost of it, the credit card arrangements, the hours of operation, exclusive marketing provisions if there are any in contracts, and the purchase of tires, batteries, and accessories.

All of those things are controlled by the supplier; yet that very supplier is able to compete with the individual or person or company to whom that supplier sells.

That, in my judgment, is a situation where unfair competition exists.

As Mr. Bedell pointed out in his testimony, current legislation is not effective to deal with this inequity.

The Robinson-Patman Act and the Petroleum Marketing Practices Act are not effective, and that is why Congress needs to act.

The courts have appeared to limit the application of antitrust laws to situations that occur between brands. They do not apply antitrust laws to intrabrand competition, which is one of our major problems in this area.

Recent court decisions affecting the Robinson-Patman Act have found many motor fuel sales at the rack to be exempt from the act because they were intrastate transactions. That, again, indicates problems with relying on that act.

The Petroleum Marketing Practices Act, while very helpful and very well-intentioned, is unrealistic for the independent small businessman to pursue because it requires a very lengthy court process.

That is why we need legislation to deal effectively with this issue.

The purpose of the legislation that is before this committee and the purpose of the legislation offered by Mr. Bedell and others of us in the House is to allow the marketers of gasoline to compete on more equal terms, where pricing, service, and consumer preference will determine change in the marketplace rather than the decisions of the suppliers of the marketers—mainly, the major oil companies.

The legislation that is offered is the outgrowth of substantial work in the molding of a variety of opinions. It is, without doubt, the product of a good deal of compromise.

I think that we can say fairly that there are five key provisions of this legislation and five key bases on which we have fashioned it.

One, it enhances competition by allowing marketers to compete on equal terms at the same starting gate. It is designed to protect the independent dealer; yet at the same time it does not permit inefficient ones to make a go of it in the marketplace.

Second, it recognizes the value of brand, which I think is something that is very important.

Third, it preserves the role of the jobber, both as a wholesaler and as a retailer. It is not the first step in an effort to divorce the jobbers from their stations.

Fourth, it prevents the erection of barriers to marketing of gasohol and allows dealers to get additional supplies in the event of unfair treatment by suppliers.

Finally, it protects the consumer. That, I think, is important for emphasis. All kinds of gasoline stations will be allowed to flourish—the gas and go's, the convenience stores, the self service, and so on.

I believe it is important to suggest that this legislation is not fashioned by any group. It is not designed specifically to protect any sector—the independent dealer or any other sector.

What it is designed to do is ensure that there is fair competition in the marketplace by making certain that all competitors begin on an even footing, and not allowing those who are competing to hold a handle over those with whom they compete.

Thank you very much, Mr. Chairman.

The CHAIRMAN. You mentioned the role of the major refiners in causing problems for the service station dealers. Do you think that eliminating the problems with refiners through divorcement will solve all the difficulties facing service station dealers?

Mr. TAUKE. Mr. Chairman, there is no question in my mind but that there are many sources of the problems facing service station dealers.

I think it is fair to say that we had in this country several years ago an overabundance of service stations. As the marketing of gasoline changed, both in the style and quantity of gasoline marketed, it was reasonable to expect that there would be many stations that would be forced to close their doors.

Our concern, however, is that some of the 80,000 stations that went out of business went out of business not because of the natural flow of the marketplace but because of the unfair competition that is occurring, we believe, in the retail gasoline industry.

As a result of that background, I think it is fair to say that divorcement is not going to solve all of the problems of service station dealers. Even if it does not solve those problems, it is important because it will allow them to compete equally.

I think that is what they are seeking, and what we should be seeking—to allow the service station dealers to compete equally in the marketplace.

If they cannot compete under those circumstances, they should not be protected. However, they should not be forced out because of unfair competition.

The CHAIRMAN. In a hearing we held several months ago, I believe, the service station dealers stated that unless something is done they are being forced out of business. And, of course, they strongly favor this bill.

Then the brokers came along and said that if we passed this law it was going to put them out of business. They are all small businessmen—the dealers and the brokers. Is there some common ground where they could get together to protect each other and not be in conflict as they appear to be now?

We have very fine dealers in my State, I know, and some very fine brokers. We do not want to see any of them put out of business if we can help it. We do not want the station people out of business, and we do not want to put the brokers out of business either. I wonder if you have any comment on that.

Mr. **Tauke**. Mr. Chairman, I know my colleague from Iowa also wishes to comment. I certainly would like you to allow him to do so.

Let me just say briefly on that question that this is an issue with which all of us have struggled.

The **Chairman**. When I said brokers, I should have said jobbers.

Mr. **Tauke**. I think I understood the context.

I think it is fair to say that from our perspective, we believed last year when we developed this legislation that the jobbers provided a service that was very important and worthwhile. It is a service that could not be supplied by many dealers themselves.

The jobbers, because they can provide that service most efficiently, would be able to survive well in the marketplace.

We have found in our own State of Iowa that many jobbers do not accept that contention. It is that very issue that perhaps is causing some difficulty for this legislation, apparently as far as this committee is concerned and also on the House side of the aisle. That is one of the areas that this committee needs to explore very carefully. I know we will continue to do it on our side.

The **Chairman**. If you have any suggestions or recommendations or proposed amendments that will protect the jobbers also so they will not suffer, I think it is well for them to be presented. That is a problem that is concerning several members of this committee, I know.

Mr. **Bedell**. May I speak to that, Mr. Chairman?

The **Chairman**. Yes.

Mr. **Bedell**. It is likely in the House version that there will be some changes in what is called the rack pricing provision. That is the provision that says that anybody, as long as they come to the rack and pick up gasoline, will be able to get it at the same price.

This was the primary concern the jobbers have. It is likely in the House there will be some changes with regard to that matter.

I think the jobbers have a legitimate concern in this regard. I happen to be in great disagreement with the jobbers, however, on one thing. That is that I think they are just looking at the short range rather than the long range.

In my opinion, it is very clear, especially after what has happened with some of the Texaco jobbers by Texaco, that if we sit idly by and let the major oil companies take over the total retail marketing, if those jobbers think for 1 minute that those major oil companies are not going to follow through by taking over the distribution of that product from themselves to their own dealers, I think they are out of their minds.

That is up to the jobbers to decide, but I would think that those jobbers should look at where they may be headed down the road.

At least in the opinion of this Member of Congress, I believe that we need to make some changes in the legislation to be sure that we do what we can to protect them. By the same token, I think those jobbers had better look at what they are faced with. If there are no dealers for them to supply, I would ask them what they think their function is going to be.

The CHAIRMAN. Senator East, do you have any questions?

Senator EAST. I have no questions.

The CHAIRMAN. Senator Grassley of Iowa just walked in. Senator, we have two Congressmen from your State. Do you have an opening statement or questions you would like to propound to them?

Senator GRASSLEY. I do not have an opening statement, but I do have some comments I want to make.

First of all, I want to apologize to my colleagues from the House, as well as my constituents, for my being late.

The reason I was late is because the Attorney General was testifying on the President's immigration policy. I am a member of the Immigration Subcommittee. I was there until now.

I do want to tell you what you probably already have found out in visiting with these folks from my State, particularly the Members of Congress, that these folks have put a great deal of thought and work into this legislation. I think they are willing to admit that it is a complicated problem, as I see it being one. However, I think they need to be recognized for this leadership.

I would also like to say that as an example of how multifaceted this legislation is and how complicated the overall problem is, an incident happened to me when I was invited to speak to an ad hoc group in the petroleum industry. It had nothing to do with this bill; it was another subject entirely.

The subject of legislation like this came up. A person who had been out of the petroleum industry for a considerable length of time and was coming back in said that this bill tries to address a real problem. The extent to which this bill might appear to be punitive to the major oil companies, this person expressed the opinion that the industry had it coming because of the way they treated service station lessees and their retailers.

He also ended by saying that even though the problem needs to exist and even though there has been that bad relationship between majors and retailers, that this bill could maybe do some harm to the gasoline dealers whom it is intended to help.

I cannot speak to the truth of those statements in the sense that this person really understood the final analysis of this bill, but I think it does lay out the complexities of the gasoline industry and this legislation.

It does seem like there is something wrong there that we need to address. The exact instrument for addressing it may be this legislation, or it may be something else.

This was the observation of that individual, and I think it expressed, as I have been listening to my colleagues and constituents from Iowa on this problem, how complicated I see it; yet I see it as a problem.

The CHAIRMAN. Thank you very much.

Again, I want to thank you gentlemen for appearing. Feel free to stay longer if you wish. If not, you are now excused.

Mr. BEDELL. Thank you.

Mr. TAUKE. Thank you.

[Material follows:]

TESTIMONY OF
CONGRESSMAN BERKLEY BEDELL
BEFORE THE
SENATE JUDICIARY COMMITTEE
ON S.326
JULY 30, 1981

MR. CHAIRMAN, AS THE CHIEF SPONSOR IN THE HOUSE OF THE SMALL BUSINESS MOTOR FUEL MARKETER PRESERVATION ACT, I AM PLEASED TO SPEAK IN SUPPORT OF S.326. AS YOU KNOW, THIS LEGISLATION IS COSPONSORED BY A BIPARTISAN GROUP OF 88 MEMBERS IN THE HOUSE OF REPRESENTATIVES.

IF THE LOBBYING -- BOTH FOR AND AGAINST THIS LEGISLATION -- IS AS INTENSE ON THIS SIDE OF THE HILL AS IT HAS BEEN ON THE OTHER, THEN I SUSPECT THE MEMBERS OF THIS COMMITTEE ARE ALREADY WELL ACQUAINTED WITH THE SPECIFIC DETAILS OF THE BILL. CONSEQUENTLY, I WILL FOCUS MY REMARKS INSTEAD ON THE HISTORY OF THIS ISSUE AND THE CONCEPTS THIS LEGISLATION EMBRACES.

ALONG WITH A LIST OF THE COSPONSORS OF HR 1362, I WOULD LIKE TO PLACE IN THE HEARING RECORD A DETAILED SUMMARY OF THE BILL'S KEY PROVISIONS.

AS YOU KNOW, THERE ALREADY IS AN EXTENSIVE RECORD OF HEARINGS AND A LARGE BODY OF EVIDENCE REGARDING THE QUESTION OF THE ABILITY OF THE SERVICE STATION DEALERS TO COMPETE ON A FAIR AND EQUITABLE BASIS WITH OTHERS IN THE GASOLINE MARKETPLACE. THE HOUSE SMALL BUSINESS COMMITTEE HELD ITS FIRST HEARINGS ON THIS SUBJECT IN THE 1960's. HEARINGS CONDUCTED BY THAT COMMITTEE IN 1975 ULTIMATELY LED TO THE THE PASSAGE OF THE PETROLEUM MARKETING PRACTICES ACT OF 1978 (PMPA).

MORE RECENTLY, THE HOUSE SMALL BUSINESS SUBCOMMITTEE ON ANTITRUST HELD EXTENSIVE HEARINGS ON GASOLINE RETAIL MARKETING PRACTICES IN 1979. THOSE HEARINGS LED TO THE DRAFTING OF THE SMALL BUSINESS MOTOR FUEL MARKETER PRESERVATION ACT OF 1980. LAST YEAR THAT LEGISLATION WAS REPORTED OUT OF THE SUBCOMMITTEE UNANIMOUSLY AND OUT OF THE FULL SMALL BUSINESS COMMITTEE BY A VOTE OF 25 - 1.

A CENTRAL THEME OF ALL THESE AND OTHER, SIMILAR HEARINGS IS THE FACT THAT WE CANNOT COUNT ON THE GIVE AND TAKE OF THE NORMAL CONTRACT BARGAINING

PROCESS TO ASSURE EQUITY IN THE RELATIONSHIPS BETWEEN MOTOR FUEL MARKETERS AND THEIR SUPPLIERS. IT SEEMS THAT WHEN THE MAJOR OIL COMPANIES "NEGOTIATE" CONTRACTS WITH THEIR MARKETERS, THE SMALL BUSINESS PEOPLE ARE EXPECTED TO GIVE AND THE OIL COMPANIES CAN BE EXPECTED TO TAKE.

THE SIMPLE TRUTH IS THAT THERE IS NO EFFECTIVE BARGAINING IN CONTRACT NEGOTIATIONS BETWEEN MAJOR REFINERS AND THEIR DEALERS. RENT INCREASES, CHANGES IN CREDIT TERMS, CHANGES IN DELIVERY POLICIES...THE RECORD IS LOADED WITH EXAMPLES OF HOW THESE CHANGES IN CONTRACT RELATIONSHIPS ARE "OFFERED" ON A TAKE IT OR LEAVE IT BASIS BY THE OIL COMPANIES.

THE TESTIMONY GIVEN TO US BY THE NATIONAL ASSOCIATION OF TEXACO WHOLESALERS CONCERNING THEIR ATTEMPTS TO DISCUSS A NEW CONTRACT WITH TEXACO EARLIER THIS YEAR IS AN EXCELLENT ILLUSTRATION OF THIS PROBLEM. TO SUMMARIZE THAT TESTIMONY, WE WERE TOLD THAT TEXACO MAILED THEIR JOBBERS NEW CONTRACTS AND THEN STEADFASTLY REFUSED TO NEGOTIATE THE NEW TERMS WITH THEIR JOBBERS OR THE JOBBER'S TRADE ASSOCIATION.

IT IS BAD ENOUGH THAT THE DEALER-REFINER RELATIONSHIP CLOSELY RESEMBLES THAT WHICH EXISTED BETWEEN MEDIEVAL SERFS AND THEIR LORDS. BUT THE PROBLEM IS GREATLY COMPOUNDED BY THE INCREASING VOLUME OF DIRECT RETAIL SALES BY THE MAJOR INTEGRATED OIL COMPANIES. THIS PUTS MAJOR REFINERS IN DIRECT COMPETITION WITH THEIR OWN MAJOR BRAND DEALERS. THE VOLUME OF SALES IN REFINER DIRECT-OPERATED OUTLETS HAS MORE THAN DOUBLED SINCE 1973. SIMILAR PROBLEMS ARE BEING EXPERIENCED TOO, BY JOBBERS WHO ARE LOSING COMMERCIAL ACCOUNTS TO THEIR OWN REFINER-SUPPLIERS.

IN HEARINGS THE HOUSE SMALL BUSINESS ENERGY SUBCOMMITTEE HELD JUST A FEW MONTHS AGO, WE ASKED WITNESSES FROM BOTH THE FEDERAL TRADE COMMISSION AND THE DEPARTMENT OF JUSTICE ABOUT THE APPLICABILITY OF THE CURRENT ANTITRUST LAWS TO THIS PROBLEM. SPECIFICALLY, WE POSED THE HYPOTHETICAL CASE OF A DEALER WHOSE REFINER-SUPPLIER LANDLORD OPENS A COMPANY-OPERATED, NON-BRANDED GAS STATION NEARBY AND THEN PROCEEDS TO RAISE THE DEALER'S RENT, TIGHTEN HIS CREDIT TERMS, AND THEN REQUIRES THE DEALER TO SELL ONLY BRANDED GASOLINE WITH ALL THE RELATED COSTS AND SERVICES ATTENDANT TO THE BRAND NAME.

WHEN ASKED SPECIFICALLY WHETHER ANY EXISTING FEDERAL LAW -- THE CLAYTON OR SHERMAN, THE ROBINSON-PATMAN ACT OR THE PMPA -- PRECLUDED THIS SORT OF BEHAVIOR, THE FTC AND THE JUSTICE DEPARTMENT WITNESSES BOTH SAID THAT NONE OF THESE STATUTES WOULD APPLY IN THIS ALL TOO FREQUENT SITUATION.

WHAT DOES APPLY, IN ONE STATE AT LEAST, IS A PROHIBITION ON MAJOR INTEGRATED OIL COMPANIES FROM DIRECT OPERATION OF RETAIL OUTLETS. MARYLAND HAS HAD SUCH A LAW SINCE 1973. (IT WENT INTO EFFECT IN 1978 WHEN A UNANIMOUS DECISION OF THE U.S. SUPREME COURT HELD THE MARYLAND DIVORCEMENT LAW TO BE CONSTITUTIONAL.)

THE COMPTROLLER OF THE STATE OF MARYLAND TESTIFIED THAT THE MARYLAND EXPERIENCE HAS BEEN QUITE POSITIVE. A STAFF ANALYSIS OF GASOLINE PRICES FOR THE SMALL BUSINESS COMMITTEE CLEARLY SHOWS THAT GASOLINE PRICES IN MARYLAND ARE NO HIGHER THAN THOSE FOUND IN NEARBY STATES THAT DO NOT HAVE RETAIL MARKETING DIVORCEMENT LAWS. (SEE ATTACHMENT)

THE TESTIMONY RECEIVED SHOWS THAT MARYLAND STILL HAS GAS-AND-GO STATIONS, HIGH VOLUME SUPER PUMPERS AND 24-HOUR SERVICES AVAILABLE. IT APPEARS THAT THE CONSUMER IN MARYLAND HAS FARED QUITE WELL UNDER DIVORCEMENT.

OF COURSE, THIS COMPLETELY CONTRADICTS THE DIRE WARNINGS OF VARIOUS SPOKESMAN ON BEHALF OF THE OIL COMPANIES. THEY SAY THAT THE PASSAGE OF DIVORCEMENT LEGISLATION WOULD CREATE CHAOS AND RAISE CONSUMER PRICES. THE MARYLAND EXPERIENCE SHOWS THESE CHARGES TO BE FALSE.

AT THIS POINT MR. CHAIRMAN, I SHOULD CAUTION YOU THAT YOUR COMMITTEE WILL HEAR A LOT ABOUT A STUDY THE DEPARTMENT OF ENERGY'S OFFICE OF COMPETITION RELEASED EARLIER THIS YEAR. THAT REPORT IS AN EMBARRASSMENT TO THE DEPARTMENT.

THE REPORT'S AUTHORS SPENT TWO YEARS PONDERING THE QUESTION OF GASOLINE MARKETING DIVORCEMENT LEGISLATION AND SOMEHOW NEGLECTED TO INQUIRE AS TO WHAT MARYLAND'S EXPERIENCE HAD BEEN. INSTEAD, THEY STAYED CLOISTERED IN THE HALLS OF THE ENERGY DEPARTMENT AND DREAMED UP SPURIOUS HYPOTHETICAL CONSTRUCTS OF WHAT MIGHT HAPPEN IN THE FUTURE. THE SO-CALLED TITLE III STUDY BY DOE PRESENTED AN UNSTRUCTURED ANALYSIS THAT WAS USED TO JUSTIFY THE DOE STAFF'S PREDETERMINED CONCLUSIONS.

AS AN EXAMPLE OF THE PROBLEMS WE HAVE WITH THE DOE REPORT, I WILL MERELY POINT OUT THAT THE REPORT WAS ISSUED IN RESPONSE TO A REQUIREMENT CONTAINED

IN TITLE III OF THE PMPA. TITLE III REQUIRED THE STUDY TO INCLUDE A REPORT ON THE FUNCTIONAL PROFITABILITY OF THE INTERGRATED OIL COMPANIES. THE REPORT WAS TO BE DELIVERED TO THE CONGRESS BY DECEMBER 1979. NOT ONLY WAS THE REPORT DELIVERED 13 MONTHS LATE, IT DID NOT INCLUDE THE REQUIRED REPORT ON FUNCTIONAL PROFITABILITY.

MR. CHAIRMAN, THE ISSUE AT HAND IS THIS: ARE WE GOING TO ASSURE THAT INDEPENDENT MARKETERS OF GASOLINE HAVE AN OPPORTUNITY TO COMPETE ON FAIR AND EQUITABLE TERMS, OR ARE WE GOING TO SIT BY IDLY WHILE THE RANKS OF THE DEALERS SHRINKS FURTHER AND FURTHER? THESE PEOPLE ARE GOING OUT OF BUSINESS NOT BECAUSE THEY CAN'T COMPETE, BUT BECAUSE THEY ARE NOT ALLOWED TO COMPETE.

IT IS VERY CLEAR TO ME THAT IF WE TRULY BELIEVE THAT THERE IS AND SHOULD BE A PLACE FOR THE LOCAL SMALL BUSINESSMAN IN THE GASOLINE RETAIL MARKETPLACE, THEN WE MUST ACT QUICKLY TO GIVE THAT INDEPENDENT MARKETER THE OPPORTUNITY TO COMPETE ON A FAIR AND EQUAL BASIS. IT IS JUST AS CLEAR TO ME THAT IF WE DO NOT DO THIS, THE CURRENT TRENDS WILL CONTINUE AND THE SITUATION WILL GET WORSE. THERE WILL BE FEWER AND FEWER INDEPENDENT BUSINESSES IN MOTOR FUEL MARKETING AND THE MAJOR INTEGRATED OIL COMPANIES WILL HAVE FURTHER CONSOLIDATED THEIR GRIP ON OUR ECONOMY. IF CONGRESS DOES NOT ACT SOON, THE RANKS OF THE 100,000 SMALL BUSINESSES CURRENTLY ENGAGED IN GASOLINE MARKETING WILL DWINDLE TO A MERE HANDFUL AND BE REPLACED BY THE SEVEN SISTERS AND THEIR CLOSE COUSINS.

LET ME GIVE YOU AN ILLUSTRATION. IN TODAY'S GLUT MARKET OF GASOLINE, SOME BROKERS HAVE PRODUCT AVAILABLE AT PRICES SOMETIMES AS MUCH AS 10¢ BELOW WHAT THE REFINERS ARE OFFERING THE SAME PRODUCT FOR SALE TO BRANDED MARKETERS. BY THE TERMS OF THEIR LEASES, HOWEVER, MOST DEALERS ARE PRECLUDED FROM HANDLING THAT LOW PRICED GASOLINE. TO FIND ANOTHER EXAMPLE OF THE CONTROL MAJOR REFINERS HAVE OVER THEIR LESSEE DEALERS ONE ONLY HAS TO LOOK AT THE CASE OF GASOHOL SALES. IF A BRANDED DEALER'S REFINER-SUPPLIER DOESN'T CARRY GASOHOL, THE DEALER CAN'T SELL IT. THESE CONSTRAINTS ON THE DEALER'S ABILITY TO RESPOND TO CONSUMER DEMANDS CLEARLY IS NOT IN THE PUBLIC INTEREST AND SHOULD BE CORRECTED BY THE LEGISLATION YOU ARE CONSIDERING TODAY.

ENACTMENT OF S.326 WOULD END THE SITUATION WE HAVE TODAY THAT FINDS ROUGHLY 100,000 SERVICE STATIONS CAPTIVE MARKETS FOR THE MAJOR INTEGRATED

REFINERS AND NO COMPETITION AT THE WHOLESALE LEVEL. AGAIN, I BELIEVE IT IS CLEAR THE CONSUMER WILL BENEFIT.

WHAT WE ARE SEEKING WITH PASSAGE OF THIS LEGISLATION IS TO REVITALIZE TENS OF THOUSANDS OF GASOLINE MARKETERS. THIS IN TURN WILL PROVIDE THE MARKETPLACE WITH A FAR GREATER DEGREE OF COMPETITION AND PUBLIC SERVICE THAN WE COULD EXPECT IF THE MAJOR REFINERS ARE ALLOWED TO CONTROL GASOLINE RETAIL MARKETING.

BERKLEY BEDELL, IOWA
CHAIRMAN

NICHOLAS MAVROULES, MASS.
CHARLES HATCHER, GA.
DENNIS E. ECKART, OHIO

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May 8, 1981

TO: Berkley Bedell, Chairman

FROM: Mark J. Levine, Subcommittee Staff

RE: Has Divorcement Increased the Cost of Gasoline in Maryland?

Background. During its recent hearings on HR 1362, the House Small Business Subcommittee on Energy heard several witnesses comment on retail gasoline prices in Maryland, a state with a comprehensive retail divorcement statute.

Louis Goldstein, the Comptroller of the State of Maryland, told the Energy Subcommittee that data from the Lundberg Letter survey of retail prices shows that gasoline prices in Baltimore were lower than those in other, comparable eastern cities. Mr. Goldstein also told the Subcommittee that dealer margins in Baltimore appeared to be higher, suggesting that divorcement in Maryland was beneficial to both the consumer and the independent gasoline marketer. Mr. Goldstein noted further that, contrary to the statements of opponents of divorcement legislation, consumers in Maryland had a wide choice of options when purchasing gasoline. He said that independent dealers were operating high volume, low priced gas and go service stations and many are open 24 hours a day. This is in addition to the many traditional full service stations in the Maryland marketplace.

However, representatives of the oil industry have suggested that Mr. Goldstein was not interpreting the Lundberg data properly. They contend that when taxes and transportation costs are figured into the data, retail prices in Baltimore were not always lower than in comparable eastern cities.

ARE PRICES LOWER IN BALTIMORE?

With the exception of the data presented by Cities Service (in the statement submitted on behalf of SIGMA, which used Cities Service's data) all of the commentators used the Lundberg Letter price survey as their data source. In a dialogue with Chairman Bedell, a witness representing the American Petroleum Institute agreed at the May 1 hearing that the Lundberg Letter probably was the best source available for information about retail gasoline prices. Cities Service performed its own in-house survey, using unique methods that make it difficult to compare their numbers with anyone else's.

A few of the commentators expanded upon Mr. Goldstein's testimony by adjusting the Lundberg data to reflect tax differentials. None of the commentators adjusted the data for transportation costs, a regretable omission since transportation costs to Baltimore would be higher than to other eastern cities such as Atlanta and Philadelphia.

The data provided by all the commentators generally shows that retail prices in Baltimore are not significantly different than retail prices in other eastern cities. In some instances, Baltimore prices are slightly lower and in others they are slightly higher. Typical of the information received by the Energy Subcommittee is this comment by Crown Central Petroleum Corp., a Baltimore-based refiner that operates retail stations on the east coast and is directly affected by the Maryland divorcement law:

> "...post-divorcement Maryland retail prices, when corrected to reflect lower Maryland taxes, appear to be right in the middle of the cities compared."

The data presented by Crown substantiates their statement. Crown compared tax adjusted retail prices in Baltimore, with prices in Atlanta, Norfolk, Washington and Philadelphia over a five month period.

Reviewing Crown's data, the subcommittee staff feels that retail prices in Washington for September and November 1980 should be omitted because a short-lived city gasoline surtax forced dealers in Washington to drastically cut their margins to stay in business. The tax was repealed in December 1980 and dealer margins returned to their normal levels. In the 18 other comparisons presented by Crown, in 9 cases prices in Baltimore were lower (in 2 cases less than 1¢ lower), and in 9 cases Baltimore prices were higher (in 3 cases less than 1¢ higher). Differentials in prices between cities fluctuate, evidencing no clear or consistent pattern in the comparison of Baltimore retail gasoline prices with those in other eastern cities.

Therefore, from the data presented by the Lundberg Letter price survey it is impossible to suggest that enactment of divorcement legislation raises the price of gasoline to consumers. On the contrary, the data comparing Baltimore with other east coast cities indicate that consumers are not adversely affected by divorcement legislation.

Attached to this memo are tables submitted by Mr. Goldstein and by Crown.

# # #

DATA PRESENTED IN THE CROWN PETROLEUM STATEMENT

GASOLINE TAX DATA

DIFFERENCES BY WHICH REGIONAL GASOLINE TAXES EXCEED BALTIMORE GASOLINE TAXES

(data in dollars per gallon)

	JUNE '80	SEPT. '80	NOV. '80	JAN. '81	FEB. '81
Atlanta	.035	.035	.035	.035	.055
Norfolk	.00	.02	.02	.02	.02
Baltimore	--	--	--	--	--
Washington, D.C.	.01	[.09]*	[.09]*	.02	.02
Philadelphia	.02	.02	.02	.02	.02

REGIONAL RETAIL PRICE DIFFERENCES ADJUSTED FOR VARYING GASOLINE TAX LEVELS COMPARED TO BALTIMORE

(data in dollars per gallon)

Atlanta	-.0192	-.0158	.0060	.0330	.0124
Norfolk	-.0188	-.0104	-.0075	-.0139	-.0152
Baltimore	--	--	--	--	--
Washington, D.C.	.0079	[-.0487]*	[-.0330]*	.0438	.0374
Philadelphia	-.0080	-.0034	.0200	.0394	.0221

*Subcommittee staff note: As can be seen, the data presented for the Washington, DC, prices was greatly affected by the short-lived city surtax on gasoline. During the time the tax was in effect dealers were forced to cut their margins and forego their profits to meet prices set by marketers in Maryland and Virginia to stay in business. When the tax was lifted, margins in Washington, DC, returned to normal levels.

DATA PRESENTED TO THE SMALL BUSINESS COMMITTEE BY
LOUIS GOLDSTEIN, COMPTROLLER OF THE STATE OF MARYLAND

RETAIL PRICES OF UNLEADED REGULAR SELF-SERVE GASOLINE*

	JUNE '80	SEPT. '80	Nov. '80	Jan. '81	Feb. '81**
Atlanta	$1.3121	$1.2381	$1.2344	$1.3080	$1.3953
Norfolk	$1.2253	$1.2285	$1.2059	$1.2461	$1.3327
Baltimore	$1.2441	$1.2189	$1.1934	$1.2400	$1.3279
Washington, D.C.	$1.2620	$1.2602	$1.2504	$1.3038	$1.3853
Philadelphia	$1.2561	$1.2355	$1.2334	$1.2994	$1.3700
U.S. Average	$1.2461	$1.2254	$1.2181	$1.2773	$1.3290

* Per Gallon prices reported by the Lundberg Letter
** Reflect decontrol

NUMBERS OF RETAIL SERVICE STATIONS

	MARYLAND	REGION***	U.S.***
JANUARY 1979	3,480	57,200	170,600
MARCH 1981	3,286	46,800	136,700
NET LOSS	194 (5.6%)	10,400 (18%)	33,900 (20%)

*** Lundberg Letter, March 20, 1981

THE SMALL BUSINESS MOTOR FUEL MARKETER PRESERVATION ACT OF 1981

Mr. Bedell et al.

SUMMARY OF KEY PROVISIONS

1. Dealers' Rights; SBA Loan Guarantees

The proprietor of any leased service station that is offered for sale by a refiner shall have the right of first refusal to purchase that station. SBA loan guarantees are made available for such purchases.

The following procedures shall be used in offering a gas station for sale to the leaseholder.

> First, the refiner shall make an offer to the lessee dealer. The dealer has 60 days to consider the offer.
>
> Second, the dealer may make a counter offer. If this is not accepted, an independent appraisal of the value of the property shall be made, subject to rules to be established by the Small Business Administration. The dealer will have the right to purchase the property at the appraised value within 30 days.

2. Divorcement; Refiner Sales Rule

Effective one year after date of enactment, major integrated refiners will be prohibited from directly operating any retail gasoline outlets. (They will be permitted to continue ownership and to operate them through lessee dealers.) The refiners who are exempted from the prohibition on operating service stations generally are those classified as small or independent refiners according to the Emergency Petroleum Allocation Act.

Small or independent refiners would be subject to a refiner sales rule. Each may sell through its own directly-operated outlets an amount of motor fuel equal to: 1) all motor fuel purchased from others; plus 2) all motor fuel manufactured by the refiner - up to 1978 direct sales total; plus 3) 50% of the excess of motor fuel manufactured above 1978 direct sales total.

3. Wholesale Transfer Pricing

Effective six months after date of enactment, suppliers of motor fuel will be prohibited from transferring motor fuel to other marketing units within their own companies at prices less than those charged independent wholesale purchasers of their products. Uniform and reasonable surcharges for the use of brand names and related services may be added to the price charged independent buyers.

4. Open Supply

Effective one year after date of enactment, it shall be unlawful for anyone to interfere with the right of a dealer to purchase, store or sell motor fuel products obtained from anyone else. Agreements providing that a dealer shall buy product only from a particular supplier would be permitted only if they specify the dealer's right to purchase product elsewhere if it is not available from the regular supplier.. Dealers operating branded stations must provide point-of-sale notice to customers if product being sold was not obtained from the brand-name supplier.

5. Information Required

Within three months after date of enactment, refiners must provide the following information to the Federal Trade Commission: a) total amount of motor fuel sold in refiner-operated outlets during the preceding year; b) total amount of motor fuel manufactured; c) total amount of crude oil produced; and d) total amount of crude oil refined. The FTC shall establish regulations for annual reports. To the extent that the information sought is available from other agencies of the government, the Commission shall waive reporting requirements.

6. Penalties; Enforcement

Violation of this Act shall be punishable by fines of up to $50,000 per month for each service station operated after the deadline for divorcement, and up to $25,000 for each 25,000 gallons of motor fuel sold in excess of the amount permitted by the refiner sales rule. Violation of the discriminatory pricing provision is punishable by fines of up to $10,000 per violation. Responsibility for enforcement is given to the FTC. In addition, individuals may bring civil actions against anyone who fails to comply with the Act.

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STATEMENT OF REPRESENTATIVE TOM TAUKE
BEFORE THE COMMITTEE ON JUDICIARY
U.S. SENATE
July 30, 1981

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to make this statement on an issue that is of the utmost importance, namely the need for greater competition in the retail sector of the gasoline industry. As one who has been closely involved with the issue for some time now -- both as a former Member of the House Small Business Committee, the Subcommittee on Antitrust, which originally reported the bill in the 96th Congress, and currently as a Member of the House Energy and Commerce Committee -- I believe that the need for divorcement legislation is now greater than ever.

I applaud the efforts of this Committee -- and you, Mr. Chairman -- to address the concept of retail gasoline divorcement. The time is now, particularly with decontrol in place, to correct the inequities in the current gasoline marketing system.

I would like to divide my remarks into three parts: (1) the need for, and purpose of, the legislation and why I believe it deserves bipartisan support; (2) a brief explanation of the major components in the bill and why I believe they are essential; and (3) my response to those who contend that the legislation is not necessary.

The extensive hearings of the House Small Business Subcommittee on Antitrust during the 96th Congress — 13 days to be exact, in addition to a number of field hearings -- revealed that fair competition does not exist in the motor fuel marketing arena. This situation is highlighted by some startling trends that occurred during the January 1972 - January 1979 period: the fact that there was a loss of more than 80,000 service station operators; the fact that more than one-third of all independently-operated stations closed their doors during those years; the fact that the total volume of gasoline sold by refiner-operated stations more than doubled; and the fact that the average volume of gasoline sold in those refiner-operated stations was much larger than the volume of gasoline sold in dealer-operated stations. These ominous trends are continuing today.

While some of these station closings, as some have argued, have been the result of normal business conditions and ineffective federal regulations, many have occurred in the wake of actions by the major oil companies -- actions that have reduced competition in the marketplace and put the independent dealers out of business.

I, therefore, urge the Members of this Committee to carefully review the House and Senate hearing records during your deliberations on the issue. Look at the trends, the testimony, and the correlation between the rise of company-operated high volume operations and the demise of dealer-operated stations. I think you will find, as we did last year -- unanimously at the subcommittee level and 25-1 at the full committee level -- that the problem at hand has been caused by unfair competition, rather than normal business conditions.

The problem -- and the most important issue -- is that lessee dealers have found themselves competing head-on with stations operated by the companies that supply them. Consequently, situations are created where the cards are stacked in favor of the major oil refiners. The refiner not only supplies gasoline to the dealer, it also controls his lease, credit arrangements, and other franchise agreements. This relationship points out an inherent inequity in the system. Moreover, it can and has been used to create an unfair advantage for the supplie

What we achieved in our Committee bill last year -- and what I hope you will report this year -- are provisions that will allow the small independent dealer to compete on an equal footing with other motor fuel marketers in the gasoline marketplace. To ensure such an outcome, we must exclude the major refiners from the retail marketplace. During the period of energy controls, they were able to manipulate regulations and business circumstances -- getting larger allocations for their new stations than existing stations received for theirs and making changes in operating policies like charging exorbitant rents -- to gain an unfair advantage over their dealer competitors. And they are able now, without controls, to aggressively embark upon marketing strategies that have company-operated stations as their main component.

Unfortunately, existing laws such as the Robinson-Patman Act and the Petroleum Marketing Practices Act have not been particularly helpful in preventing abuses in gasoline marketing. As a representative of a small business association testified at our hearings,

> It is true that the Petroleum Marketing Practices Act of 1978 does provide for the protection of distributors and retailers of gasoline under a national trademark by establishing protection from arbitrary or discriminatory terminations or nonrenewals of leases, prohibiting the refiners and resellers from

> failing to renew a relationship, unless such action is based upon grounds described in the Act. The Act has a serious flaw, however, in that it does not address the economic eviction techniques that are being used extensively by many of the refiners in attempting to increase control of the retail end of the business. In addition, even if the Act were to deal with those practices, the length of time and great legal expenses involved in seeking legal recourse via the courts makes it extremely difficult for the independent dealer to use such an avenue successfully.

Our existing laws have not been effective in providing relief to dealers who suffer from unfair competition. Divorcement is the remedy that we need.

In conjunction with oil and gasoline deregulation, the divorcement legislation, with its wholesale pricing and open supply provisions, will allow the market forces to operate in ways that are healthy for the industry. Fair competition is all that this bill is seeking. The preservation and encouragement of competition is the appropriate responsibility of the federal government. It must be the referee in the marketplace to ensure that everyone is given a "fair shake" -- to see that everyone starts at the same gate, so to speak. Under this legislation, an atmosphere will be created in which the gasoline dealer has a fair chance to survive and compete, although he still must meet the challenge. It appears to me, therefore, that both Republicans and Democrats can find this an attractive issue to support.

To achieve the ultimate goal of fair competition, the bill includes the following major provisions:

> (1) Divorcement language to prevent the major oil companies from directly competing with the lessee dealers they have traditionally supplied. Small or independent refiners, classified as such by the Emergency Petroleum Allocation Act, are not removed from the retail marketplace if they meet a small refiner standard. Each may sell through its own outlets an amount of motor fuel equal to: all motor fuel purchased from others; all motor fuel manufactured by the refiner up to its 1978 direct sales levels; and 50 percent of the excess above that level.
>
> (2) A wholesale transfer pricing mechanism requiring suppliers to transfer motor fuel to marketing units within their particular company at the same price that they would charge independent wholesale purchasers of their product. This provision was included to rectify the problem of a supplier providing gasoline at different prices to different customers who often compete with one another.
>
> (3) A "modified open supply" measure to allow dealers to obtain motor fuel products from other sources when their regular suppliers are unable to meet their supply needs. Not only will this provision allow a dealer to obtain gasoline from another source if his normal supplier does not provide sufficient product, but it will also permit the dealer who cannot obtain gasohol from his normal supplier to purchase it elsewhere. At the same time, it recognizes the value of a brand name product by requiring dealers to notify their customers at point of sale of the availability of other types of gasoline.

(4) A procedure to be followed by owners and lessee dealers during the sale of gasoline stations. A proprietor of a leased service station offered for sale by a refiner would have the right of first refusal to purchase the station, and small business loans would be made available to those who are interested in purchasing their own stations.

All in all, the legislation makes necessary changes in an industry that is extremely complex. Based on the volumes of evidence that have been studied, it molds the viewpoints of marketers and small refiners into a reasonable and acceptable package.

The bill enhances competition by allowing independent branded dealers, independent non-branded dealers, and jobbers who market gasoline through their own stations to compete under fair and equitable conditions. At the same time, it recognizes the value of a brand name and preserves the role of a jobber as a wholesaler of gasoline -- and as a retailer, if he so desires. The bill is not intended to be the first step toward preventing jobbers from operating their own retail outlets. The legislation also prevents the erection of obstacles to the marketing of gasohol. And it prevents the major oil refiners from gaining a stranglehold on the marketplace.

In the end, the legislation will protect the consumer. The bill encourages the existence of conditions that lead to healthy competition and, therefore, lower prices. Gas-and-go operations, self-service stations, and operations run by independent marketers, who have historically provided the public with the cheapest gasoline, will still be allowed to flourish. What is important is that the bill will allow changes in the marketplace to occur as a response to consumer demand, rather than as a result of the marketing strategies of the largest oil refiners.

The CHAIRMAN. Our next witnesses are John J. Flynn, University of Utah, Salt Lake City, Utah, and Mr. Robert S. Campbell, Jr., Watkiss & Campbell, Salt Lake City, Utah.

Gentlemen, please have a seat. We will be pleased to hear from you now.

STATEMENT OF JOHN J. FLYNN, UNIVERSITY OF UTAH, SALT LAKE CITY, UTAH

The CHAIRMAN. Are you appearing in favor of the bill or opposed to the bill?

Mr. FLYNN. I am in favor of the bill, Senator. Mr. Campbell is opposed to the bill.

The CHAIRMAN. We will be glad to hear from you.

Mr. **Flynn**. My name is John Flynn. I am appearing on behalf of the Service Station Dealers of America. I am attorney and professor of law and a student of antitrust law.

I have prepared a very lengthy statement analyzing the problems of petroleum retailers, justifications for this bill, and the justifications—economic and otherwise—for divorcement of refiner-owned stations.

I do not propose to read that statement but to submit it for the record, to the relief I am sure of everyone.

The **Chairman**. Your entire statement will be placed in the record at the completion of the oral presentation of the panel. You may proceed to summarize it.

Mr. **Flynn**. I have also prepared a written summary of my statement.

Looking at the clock and having once worked as a staffer on the committee, I know that the big cost here is time.

I would like to insert this oral testimony also and just briefly outline it so that Mr. Campbell and I and the members of the committee can have an interchange, which I think is perhaps far more beneficial.

The **Chairman**. Without objection, that will be done.

SUMMARY STATEMENT

Mr. **Flynn**. This written outline of my testimony briefly suggests that the major problem in this industry is regional concentration.

You will hear Mr. Campbell talk about the market share of the majors nationally. I would agree with Bob's assessment that nationally no one company has an overwhelming share. That is not the crucial fact.

When you look at regional markets, there is quite a degree of high concentration. For example, in Salt Lake City, we have six refineries. Two of them have the overwhelming share of the market. Those same two control the crude and product pipelines into and out of the market. That is where the crux of the problem is when we have vertical integration taking place and a noncompetitive market structure upstream.

That reality of regional market power by control of refinery or pipeline terminals, in connection with vertical integration, justifies divorcement of refinery-operated outlets and money markets in this country.

Most of the vertical integration is taking place where those majors do have the predominant role in refining or product pipelines.

The final section of my written statement analyzes the specifics of S. 326.

The problem that is left, if divestiture takes place, is that most branded dealers will still be locked into a single supplier as a result of their franchise and trademark license, while their competitors are free to buy products at the best price they can.

It is not unusual for gasoline refined at a particular refinery to be sold at a wide variety of prices—prices which fluctuate according to whether it is sold to locked-in branded dealers unable to buy products elsewhere, captured customers if you will; jobbers who may be accorded functional discounts, and sometimes other discounts not related to any particular functional benefit they confer; prices to other major oil companies in their exchange agreements; and prices to independents and jobbers on the spot market.

The same gasoline coming from the same refinery may carry with it several different prices.

The effects of those various prices for the identical gasoline coming from a single refinery are apparent in the retail market. Branded retailers are locked out of buying products through channels other than those required by their franchisors. They end up starting out of the gate in the race for the consumer's dollar with the highest wholesale price, which is frequently a wholesale price equal to the retail price at refiner-owned and jobber-operated stations.

Just before coming back to Washington we ran a little survey in Utah. A company-operated pumper station was selling at retail at a $1.249. They were charging their branded retailers a wholesale price of $1.246. That is three-tenths of 1 cent difference.

I do not think you need a Ph. D. in economics to know what that does out on the street.

A branded retailer finds it impossible to compete in price and has no way of obtaining the product at a cheaper price.

My statement also outlines justifications for what is known as open supply, or the right of a dealer to buy in the open market when and if he can, so long as he does not sell the product under the brand of his franchisor.

I think passage of that part of S. 326 is going to immediately generate thousands of new potential competitors in the wholesale market for gasoline, balance the relationship of the major refiner and his franchise stations, and enable franchised dealers to resist the overwhelming power and control of their franchisor.

The gist of the franchise system of marketing, theoretically at least, is an equal bargaining relationship. That does not exist today in gasoline. I think just about everyone recognizes that.

Freeing up dealers so that they can take advantage of open supply, will help provide a counterweight to the otherwise overwhelming power of the franchisor.

The bill prohibits misbranding so that a dealer selling gasoline from sources other than his trademark licensor will only be able to sell the product from other sources if the pump it is sold from is debranded.

Failure of a dealer to do this would probably cause loss of his protection under the Petroleum Marketing Practices Act.

I think the legislative history of S. 326 should make clear that a branded dealer, taking advantage of the open supply provision and not misbranding the product by selling it under the franchisor's trademark, does not lose the protections of the Petroleum Marketing Practices Act.

Under section 102 of that act, a franchisee may be terminated for failure to comply with a reasonable and material aspect of the franchise relationship.

It should be made clear that taking advantage of the open supply provisions of S. 326 would not constitute a ground for termination under the Petroleum Marketing Practices Act.

My statement ends with the usual flowery conclusion and peroration which I will avoid subjecting you to and ask if perhaps Mr. Campbell and I could engage in a little dialog.

The CHAIRMAN. Thank you very much.

Mr. Flynn, you criticized the DOE study because it takes account of only variable costs and not fixed or joint costs in testing for below-cost pricing. Is this the Areeda-Turner standard that has been adopted in many antitrust cases for determining below-cost pricing?

Mr. FLYNN. I think that is a fair assessment of Areeda-Turner. I question whether that test has been adopted in a lot of antitrust cases. It has been in some and rejected in others.

If I were to be asked as an antitrust expert which way the wind is blowing, I would suggest that the Areeda-Turner variable cost test is basically being rejected in favor of a fully distributed cost test.

The CHAIRMAN. I observe that on the one hand you have criticized a conclusion reached by the DOE study that there is no cross-subsidization of retail gasoline operations by refiners. Yet on the other hand, you state that the possibility of making profits at retailing has accelerated vertical integration by firms with local refining capacity or pipeline control.

Would you mind clarifying whether you think that in today's market refiners are subsidizing their retail operations or making a profit off them?

Mr. FLYNN. I think the problem today in most markets—it may be occurring in some, and Professor Allvine is here to talk about subsidization—is predatory costing and not predatory pricing.

The distinction, and it may sound paradoxical at first, is that it is equally unlawful to achieve or to price products to a retailer at a wholesale cost that he cannot make a profit at.

We have had some instances of that in industries where you have local or regional upstream market control—I think particularly the electric utility industry.

The point is that they are charging too high a price at wholesale to their retailers and then selling at retail at a price that the retailer cannot meet. That is called predatory costing. I think that is the prevalent practice today.

As I indicated, for example in Salt Lake City, we have that situation going on regularly. I have talked to dealers around the country, and the same thing is happening elsewhere.

It is not a question of predatory pricing or subsidizing a low price in a market with high prices elsewhere—although, again, that may be existing in some markets. I know that Professor Allvine can detail those for you.

My concern is predatory costing—having your retailer in the position where you can elevate his wholesale costs to a point where he cannot compete. That is what is happening.

The CHAIRMAN. I believe you stated that in Utah, Amoco sells its Rainbo brand gasoline at retail prices, below what it charges dealers wholesale. Does Amoco also operate Amoco brand retail outlets in the area? If so, what are its pricing policies at those stations?

Mr. FLYNN. There are a few Amoco-branded stations left. At those stations, I checked before coming here, the price wholesale to the branded station was three-tenths of a cent below the retail price at Amoco's wholly operated outlets.

Paul Ashton, the head of the Utah Dealers Association, is here with further testimony on those pricing practices.

It has been running at or slightly below the retail price of Amoco charger at its wholly owned outlets.

The CHAIRMAN. Would you say that it is somewhat shortsighted of a refiner to try to make profits off its retailers by selling it at prohibitively high wholesale prices, since its dealers will thereby be forced out of business altogether?

Mr. FLYNN. Not if you were taking over the retail market—not at all. In fact it is highly rational to do so, because you can take monopoly power at one level of the market and translate it into the other and extract monopoly profits at retail as well as wholesale.

The CHAIRMAN. If your prediction that even with direct pricing jobber-operated retail chains and dealer cooperatives will ultimately evolve to be the major wholesale forces in the market is accurate, is divorcement of refiners from retail gasoline stations really going to be effective in helping the plight of the independent service station dealer?

Mr. FLYNN. Yes, Senator.

In the absence of it, it would be my judgment that that evolution of retail chains, jobber chains, and dealer cooperatives will not take place at all. Instead, we will have a leapfrogging of all of that potential development and the counterweight to monopoly power and regional market control by and the creation of oil company-operated outlets.

In the absence of divorcement, I do not think that the development you mention, and I advocate, will take place.

The CHAIRMAN. You heard my statement a few moments ago about the retailers and the jobbers.

Mr. FLYNN. Yes, Senator.

The CHAIRMAN. Do you feel that this bill would jeopardize the jobbers? If so, what could be done to be fair to the retailers and the jobbers.

Mr. FLYNN. In the divorcement and open supply provisions, as a practical matter, I do not see any problems for the jobbers on those two.

I think where the area of disagreement is between dealers and jobbers, and there are all categories of jobbers involved, is in the rack-pricing provision.

As I understand it, the present bill would provide a daily transfer price that you could not vary from at a refinery. The jobbers object to this. Some jobbers are in the position of buying on the spot market and providing, for example, the service of taking over supply.

They would be concerned about that because the risk they are taking and the pricing they will get perhaps will not be commensurate.

It is my understanding that there is a dialog going on between the jobbers and the dealers on the rack-pricing provisions. I think I would support any kind of a dialog that was ultimately aimed at getting the jobbers and the dealers together on divorcement and open supply and leaving the question of rack pricing and how you deal with discriminatory pricing perhaps to some other bill.

The CHAIRMAN. Do you feel that this particular legislation needs any amending that would be fair to the dealers and the jobbers, or do you feel that this legislation as it is now written is fair to both?

Mr. FLYNN. I think it is possibly fair to both now, although I still have questions. I have not thought through how the rack-pricing provisions would affect all classes of jobbers. Some jobbers I do not see any problem for them. Others it may. I am just not clear on the facts of how it would work.

The CHAIRMAN. Would you mind looking into that further and giving us your opinion? If you feel any amendments are needed, would you propose those?

Mr. FLYNN. I certainly will, Senator.

The CHAIRMAN. The distinguished Senator from Ohio.

Senator METZENBAUM. Thank you, Mr. Chairman.

Mr. Flynn, does vertical integration by refiners bring about any special kinds of efficiencies?

Mr. FLYNN. Everybody I have talked with and every study of the industry says absolutely not. There are no efficiencies to be realized by vertical integration.

I think Bob Campbell has alluded to some that he sees. I have never seen that argument made, and I do not see why vertical integration would provide any efficiencies whatsoever.

Senator METZENBAUM. From your knowledge, what has been Maryland's experience with its divorcement law?

Mr. FLYNN. Basically, the prices in Maryland have not increased. They have been somewhat below the national average.

The historic spread between Maryland's prices and Pennsylvania, for example, has been pretty well maintained. It has not had any dramatic effect other than perhaps to permit dealers to have more confidence in their operation and, therefore, upgrade their operation.

Senator METZENBAUM. Have the independents been able to operate as efficiently as the company-operated stations that they displaced?

Mr. FLYNN. Yes, Senator, all classes. There are pumpers and so on.

Senator METZENBAUM. To me the bottom line on this whole question is not really the dealers or the companies. It is a question of how have the consumers fared? I think that is really what should concern us all. Do you have an opinion on that?

Mr. FLYNN. That is an important question and a difficult one to sort out.

You have to look at both long and short haul. I think short-haul consumers may be led to believe that they are getting an advantage from pricing practices at refinery-run outlets. Those same advantages would be available to the consumer if branded dealers had the supply and the right to pump through self-serve. Some of them do it now.

I do not see why it has to be done by a company operation.

The long-haul problem I see is that unless this trend is stopped, the takeover of the retailing end of the market, we are going to have a translation of market power from the refining and pipeline level down to retailing. The long-term prospect would be much higher prices than would otherwise prevail if we maintain a competitive structure at the retail level.

Senator METZENBAUM. Am I correct in my assumption that generally speaking free competitive forces permitted to operate in our economy really do the most for the economy, most for the free enterprise system, and probably most for the public?

Mr. FLYNN. That is the general assumption that I think we all operate on; yes, Senator.

Senator METZENBAUM. And when the companies have their own stations competing with the independents, is it pretty much recognized that by their ability to low-ball the price as against the independent until they can squeeze them up against the wall or use some other anticompetitive practice, they can drive out the independent and then subsequently come back in with these considerably higher prices?

Mr. FLYNN. That would be the projection, certainly—particularly if they have market power at the refining and supply levels.

Senator METZENBAUM. I am not sure that you are in a position to answer this, but I noticed that the competitive price for gasoline is totally different as you travel around the country.

In California it is around $1.45 to $1.51, with many refiners there and much oil there. You come to Washington, and it is somewhere around $1.35 to $1.40. I am talking now about unleaded gasoline. You go to Ohio and you find the price considerably lower than that. It may be $1.25 to $1.30.

Do you have any opinion as to why we do not have comparable price figures in the various States, particularly where you find a State such as California which has its own product available and also has its own refineries and still charges one of the highest prices in the country?

Mr. FLYNN. Yes; I do.

Gasoline and refined products generally are not like newspapers that you can ship all over the country. It is very heavy and bulky stuff. It is highly dangerous. The transportation and refining pattern of the country, which is not very well understood, is absolutely crucial.

Again, I refer to Bob's comments that he will be making about the national picture on market share of the majors, showing no big concentration. That is not the number you have to look at.

Because of the nature of the product, the way it is produced, the way it is refined, and the way it is marketed, you have to look at regional markets.

For example, on the west coast you may have higher prices because you do not have access, for example, to low cost-crude being marketed through OPEC right now. Ten weeks from now if that picture changes, you will have high prices on the east coast and lower prices on the west coast, simply because of the transportation and refining and marketing structure of the industry.

I do not think it is something that you should necessarily attribute to some kind of conspiracy or otherwise. It is just the nature of the beast—where the product is, how it is refined, and how it is transported is absolutely crucial.

Senator **Metzenbaum**. Mr. Flynn, isn't there considerable support for the very point you are making from one of the major factors in the industry at the moment? That is Conoco, which has filed an antitrust complaint against Mobil. Have they not actually alleged as a part of their case that this regional concentration is a far more important factor than the share of the market nationally?

Mr. **Flynn**. It is strange you should ask about that. I picked up the Conoco complaint this morning, because one of the issues I wanted to find out was whether or not Conoco had produced some numbers, that are very hard to come by, on regional market shares. They have done so.

Rather than go through it all, because it is a very lengthy complaint, I would like to insert it in the record. It does indicate exactly what you are suggesting, Senator.

That is that the crucial thing to look at for competition in this industry is regional market structure.

If I might, Senator, this is the complaint filed in the District Court for the District of Columbia by Conoco against Mobil Oil Corp. to enjoin Mobil's attempted takeover of Conoco.

The relevance for this hearing is that it contains a number of statements in support of exactly the position I have been suggesting by, I guess, one of our many major oil companies.

The **Chairman**. We would be very pleased to receive that in the files of the Judiciary Committee. That is not to go in the record.

Senator **Metzenbaum**. Mr. Chairman, I think that since Conoco is the ninth largest oil company in the Nation, and since they are certainly an important spokesperson for the industry, when in an official complaint filed with the court they indicate that this regional concentration question is a major factor, and is far more important than the national concentration, I would hope that you might see fit to put it in the record, Mr. Chairman. I think it is very legitimate.

The **Chairman**. Without objection, it will be put in the record.

[Material follows:]

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CONOCO INC.,
High Ridge Park
Stamford, Connecticut 06904

Plaintiff,

v.

MOBIL CORPORATION and
MOBIL OIL CORPORATION,
150 East 42nd Street
New York, New York 10017

Defendants.

OBERDORFER, J. A

CIVIL ACTION
NO. 81- 1694

ANTITRUST COMPLAINT

FILED
JUL 23 1981
JAMES F. DAVEY, Clerk

Plaintiff, Conoco Inc. ("Conoco"), by its attorneys, brings this action for preliminary and permanent injunctive relief under the federal antitrust laws against defendants Mobil Corporation and Mobil Oil Corporation (collectively "Mobil") and complains and alleges the following:

I. JURISDICTION AND VENUE

1. This action is brought pursuant to Section 16 of the Clayton Act, 15 U.S.C. § 26, to prevent and restrain threatened violations by defendants of Section 7 of the Clayton Act, 15 U.S.C. § 18. This Court has jurisdiction of this action pursuant to Sections 1331 and 1337 of the Judiciary Code, 28 U.S.C. §§ 1331 and 1337.

2. Defendants Mobil and Mobil Oil are found and transact business in this District; are engaged in commerce; and are within the jurisdiction of this Court for purposes of service of process.

3. Many of the acts and transactions alleged herein are being carried out, have effect, are occurring and, unless enjoined, will continue to occur within this District. Venue is

proper in this District pursuant to Section 12 of the Clayton Act, 15 U.S.C. § 22, and Section 1391 of the Judiciary Code, 28 U.S.C. § 1391.

II. THE PARTIES

4. Plaintiff Conoco is a publicly held corporation organized and existing under the laws of the State of Delaware, with its principal executive offices in Stamford, Connecticut.

5. For its fiscal year ended December 31, 1980, Conoco reported net income of $1,026,200,000 on total revenues of $18,766,300,000. Conoco is the ninth largest oil company headquartered in the United States as ranked by total sales and by assets, and is the fourteenth largest industrial corporation in the United States, as ranked by total sales and by net income, and the eighteenth largest such corporation as ranked by assets.

6. Defendant Mobil is a corporation organized and existing under the laws of the State of Delaware with its principal executive offices in New York, New York. Mobil is a holding company whose origins stem from the Standard Oil Company of New York, originally a member of the Standard Oil Trust, and from the Vacuum Oil Company, another member of that combine which had been dissolved in 1912 following a Supreme Court decision ruling that it violated the Sherman Antitrust Act. In 1931 the Standard Oil Company of New York and the Vacuum Oil Company merged to form the Socony-Vacuum Oil Company, which in 1966 changed its name to Mobil Oil Corporation.

7. For its fiscal year ended December 31, 1980, Mobil reported net income of $3,272,000,000 on total revenues of $63,726,000,000. Mobil is the second largest oil company headquartered in the United States as ranked by total sales, assets

and net income. Mobil is the second largest industrial corporation in the United States, as ranked by sales and the third largest as ranked by assets and net income. Mobil describes itself as "one of the world's largest companies."

8. As fully integrated multinational oil companies, Mobil and Conoco compete in numerous product and energy markets:

Mobil	Conoco
(a) Mobil operates in over 100 countries.	(a) Conoco operates in over twenty countries in North and South America, Europe, Africa, Asia and Australia.
(b) Mobil is engaged in the exploration for, development and production of crude oil, natural gas and natural gas liquids; the refining of crude petroleum; and the transportation and marketing of crude oil, natural gas liquids and refined petroleum.	(b) Conoco is engaged in the exploration for, development and production of crude oil, natural gas and natural gas liquids; the refining of crude petroleum; and the transportation and marketing of crude oil, natural gas liquids and refined petroleum.
(c) In the United States, Mobil is a major producer of crude oil and natural gas and a leading refiner	(c) In the United States, Conoco is a major producer of crude oil and natural gas and a leading refiner and marketer

	and marketer of petroleum products. It produces oil in 15 countries, has 35 wholly or partly owned refineries and operates a fleet of 100 ocean-going vessels.		of petroleum products. It produces oil in 7 countries, has 8 wholly or partially owned refineries and operates a fleet of ocean-going vessels with a capacity of 1,601 deadweight tons.
(d)	As of December 31, 1980, Mobil had at least 2,251,000,000 barrels of net proved petroleum reserves world-wide, and is the tenth largest holder of proved petroleum reserves in the United States with 890,000,000 barrels. These figures do not include Mobil's share of the substantial reserve holdings of the Arabian-American Oil Company (ARAMCO), which it owns in partnership with	(d)	As of December 1, 1980, Conoco had 1,988,000,000 barrels of proved petroleum reserves world-wide, and was the fifteenth largest holder of proved petroleum reserves in the United States, with holdings of 403,000,000 barrels. In addition, Conoco holds under lease 4,017,000 acres of undeveloped petroleum properties in the United States.

	Exxon, Standard of California and Texaco, its competitors in the United States.		
(e)	As of December 31, 1980, Mobil had total world-wide production of petroleum liquids of 700,000 barrels daily, and 368,000 barrels daily from its United States operations, and ranked sixth in production domestically.	(e)	As of December 31, 1980, Conoco had world-wide production of petroleum liquids of 458,000 barrels daily and 143,000 barrels daily from its United States operations, and ranked sixteenth in production domestically.
(f)	In 1979, Mobil ranked seventh in the United States in the ownership of interstate oil pipelines.	(f)	In 1979, Conoco ranked fifteenth in the United States in the ownership of interstate oil pipelines.
(g)	Mobil owns the largest number of miles of crude oil gathering pipelines in the United States.	(g)	Conoco owns the second largest number of miles of crude oil gathering pipelines in the United States.
(h)	As of December 31, 1980, Mobil owned and operated seven petroleum	(h)	As of December 31, 1980, Conoco owned and operated seven

	refineries in the United States, with a total capacity of 899,600 barrels daily, and ranked seventh in domestic refining capacity.		petroleum refineries in the United States, with a total rated capacity of 455,000 barrels daily, and ranked thirteenth in domestic refining capacity.
(i)	Mobil markets motor gasoline in forty-eight states, through 17,425 branded retail outlets.	(i)	Conoco markets motor gasoline in forty-one states, through 5,605 branded retail outlets.
(j)	Mobil is the tenth largest holder of proven coal reserves in the United States.	(j)	Conoco, through its Consolidation Coal Company, is the largest holder of proven coal reserves in the United States and is this nation's second largest coal producer.
(k)	As of 1979, Mobil was tied with Conoco as the fifth largest holder of uranium concentrate reserves in the United States.	(k)	As of 1979, Conoco was tied with Mobil as the fifth largest holder of uranium concentrate reserves in the United States.

(l)	Mobil is a major producer of natural gas. For the year ended December 31, 1980, Mobil produced 3,510,000,000 cubic feet daily of natural gas world-wide, and 2,285,000,000 cubic feet daily in the United States and ranked fourth in domestic production. It also ranks fourth in domestic production of natural gas liquids.	(l)	Conoco is a major producer of natural gas. For the year ended December 31, 1980, Conoco produced 1,364,000,000 cubic feet daily of natural gas world-wide, and 778,000,000 cubic feet daily in the United States and ranked sixteenth in domestic production. It also ranks ninth in domestic production of natural gas liquids.
(m)	Mobil is a significant producer of regular-grade low sulfur petroleum coke.	(m)	Conoco is a significant producer of regular-grade low sulfur petroleum coke and is the largest domestic producer of premium petroleum coke, which is used in the production of electrodes for steel-making furnaces.

9. Conoco participates in numerous joint ventures with other oil companies in the ownership of federal offshore oil and gas producing properties, in the ownership and operation of natural gas processing plants and related gathering pipeline systems, in crude oil trunk pipelines, and in refined product and natural gas products pipelines. Its partners in these ventures include ARCO, Cities Service, Exxon, Getty Oil, Gulf, Mobil, Tenneco, Standard of California, Standard of Indiana, Superior Oil, Texaco, TransOcean (now Mobil), and Shell. Conoco has significant joint interests in potential oil producing properties in Alaska and is in partnership with Gulf for oil and gas exploration on over one million acres in the Williston Basin area of Montana and North Dakota. Overseas, Conoco participates in joint ventures with other oil companies in the North Sea, Africa, the Middle East and Southeast Asia.

10. Mobil, together with Exxon, Texaco and Standard of California, which individually are the four largest oil companies in the United States, are owners of the Arabian-American Oil Company (ARAMCO). That consortium accounts for virtually all of the crude oil production in Saudi Arabia, the world's largest exporter of crude oil and, next to the United States, the leading oil producing country in the free world. Through ARAMCO, Saudi Arabian crude oil supplies a significant percentage of the United States' demand for oil. Mobil, together with the other owners of ARAMCO and the Saudi government, has developed a long-term relationship based upon a mutuality of interests to produce and market Saudi crude oil. Mobil has entered into partnership relationships with the Saudi government to process, transport and market crude oil and petroleum products and has at least one Saudi Arabian citizen on its board of directors.

11. Mobil also participates in joint ventures with other major oil companies in other overseas areas and in the United States. These include exploration and production properties, crude oil and refined product pipelines; natural gas processing plants and associated gathering lines. Its partners in various of these ventures include Conoco, ARCO, Cities Service, Exxon, Getty, Gulf Oil, Standard of California, Standard of Indiana, Phillips, Shell, Standard Oil of Ohio, Texaco and Union. Through these ventures, Mobil's interests are linked with virtually every other major oil company.

12. Mobil's growth and enormous size is partly the result of mergers and acquisitions. For example, in the past few years Mobil has made the following acquisitions:

(a) In 1974 Mobil acquired a majority interest in Marcor, Inc., and thereafter in 1976 acquired all of Marcor.

(b) In 1979 Mobil acquired General Crude Oil Co. for $792 million.

(c) In 1980 Mobil acquired TransOcean Oil, Inc. for $715 million.

(d) In 1980 Mobil acquired the Vickers Energy Corporation.

III. THE MOBIL OFFER

13. On July 17, 1981, Mobil made a tender offer (the "Offer") to purchase 43,500,000 shares of Conoco for $90 per share.

14. If Mobil acquires those shares it will own, directly or indirectly, a majority of Conoco's outstanding shares of common stock. Following the completion of the Offer,

Mobil intends to merge Conoco into Mobil or a wholly owned subsidiary of Mobil, pursuant to which the remaining shareholders of Conoco would receive shares of preferred stock of Mobil Oil and/or debentures of Mobil.

IV. TRADE AND COMMERCE

15. The oil industry is comprised of four basic levels of operation: the exploration for and production of crude oil, natural gas and natural gas liquids; the transportation of liquid petroleum and refined products; the refining of crude oil; and the marketing of refined petroleum products.

16. A large number of entities are engaged in one or more levels of the petroleum industry. However, a vast disparity exists in the size and scope of the operations of these entities. They range from multibillion dollar, multinational corporations, such as Mobil and Conoco, which are vertically integrated into all levels of the petroleum industry, to individual proprietors who may have but an interest in a single oil well or operate one independent retail gasoline station.

V. VIOLATIONS ALLEGED

17. If Mobil were to acquire Conoco the expected result of such acquisition will be substantially to lessen competition and to tend to create a monopoly in violation of Section 7 of the Clayton Act in both national and local markets in the following lines of commerce, among others: the exploration for, production and acquisition of crude oil; the refining of crude oil; the sale of refined petroleum products including motor gasoline, distillate fuel oil, diesel fuel and petroleum coke; the operation of natural gas processing plants and the sale of natural gas liquids; and the acquisition and sale of uranium and coal.

COUNT ONE

(Elimination of Horizontal Competition in the Oil Industry)

18. Conoco repeats and realleges the allegations of paragraphs 1 through 17, inclusive, of this Complaint, as if fully set forth herein.

19. Mobil and Conoco are both large, integrated oil companies and, as such, compete with each other and other large integrated oil companies in a number of related product lines. Mobil's and Conoco's ranks in the following petroleum product lines have been estimated as follows:

	Mobil Rank	Conoco Rank	Combined Rank
U.S. Energy Producing Companies on a B.T.U. Basis, 1979	9	5	2
U.S. Energy Producing Companies on a Dollar Basis, 1979	8	10	2
U.S. Crude Oil, Condensate and Natural Gas Liquids Production, 1979	9	16	6
U.S. Natural Gas Production, 1979	4	16	3
Proven U.S. Natural Gas Reserves, 1979	7	16	4
U.S. Refining Capacity, 1979	8	15	4
U.S. Refinery Crude Runs, 1979	8	14	2
U.S. Interstate Oil Trunk Line Barrel Miles, 1979	7	14	1
U.S. Refined Product Sales, 1979	7	15	4
U.S. Motor Gasoline Sales, 1979	6	13	2

There are regional and local markets where the market shares and ranks are even greater and the effect of the combination of the two companies would be even more substantial. These changes in rankings are particularly significant in this industry which has such a vital significance to the nation.

20. Since the announcement of Mobil's interest in acquiring control of Conoco, other major, fully integrated oil companies have publicly announced the fact that they are arranging credits of billions of dollars.

(a) On July 20, 1981, Gulf Oil, the nation's seventh largest integrated oil company in terms of production and sixth largest in terms of refining capacity, announced that it had arranged stand-by credit of about $5 billion "in order to be financially ready to act on opportunities which may be present in today's business environment."

(b) On July 10, 1981, it was announced that Texaco, the nation's sixth largest integrated oil company in terms of production and the fifth largest in terms of refining capacity, was negotiating a $5.5 billion line of credit.

(c) On July 14, 1981, Marathon, the nation's fourteenth largest integrated oil company in terms of production and ninth largest in terms of refining capacity, acknowledged that it had been seeking funds understood to total $5 billion.

(d) On July 10, 1981, Pennzoil, the nation's twenty-sixth largest integrated oil company in terms of production and forty-first largest in terms of refining capacity, announced that it was arranging a $2.5 billion line of credit with Citibank.

(e) On July 14, 1981, it was announced that Cities Service, the nation's fifteenth largest integrated oil company in terms of production and seventeenth largest in terms of refining capacity, is understood to have negotiated a $1 billion loan to protect itself, and to be in a position to frustrate any offer.

21. As these announcements indicate, the Mobil acquisition of Conoco, if allowed to proceed, would tend to trigger additional oil company acquisitions that would further reduce competition in the integrated oil business.

Effects of the Proposed Acquisition

22. The effects of the proposed acquisition of Conoco by Mobil will be substantially to lessen actual and potential competition in the broad range of products and businesses in which they are presently substantial competitors in violation of Section 7 of the Clayton Act in the following ways, among others:

(a) Actual competition between Conoco and Mobil in the acquisition and control of petroleum supplies and in the marketing and sale of all types of petroleum products will be eliminated, lessened or foreclosed in national and regional markets.

(b) Potential competition and the potential for increased competition between Mobil and Conoco in all types of petroleum products may be eliminated, lessened or foreclosed in national or regional markets.

(c) Mergers or acquisitions between other major integrated oil companies selling many of the same petroleum products will be fostered, thus creating the likelihood of a further substantial lessening of competition.

COUNT TWO

(Elimination of Horizontal Competition in the Acquisition of Crude Oil)

23. Conoco repeats and realleges the allegations of paragraphs 1 through 21, inclusive, of this Complaint, as if fully set forth herein.

24. Substantially all of the crude oil produced in the United States is transported to refineries by pipelines. Crude oil gathering pipeline systems form an integral part of the oil field purchasing organizations of oil companies to secure supplies of crude oil for their businesses.

25. With 4,449 miles of gathering lines, Mobil ranks first in the United States with 11.9% of total U.S. gathering line mileage. Conoco ranks second with 4,071 miles which represents 11.2% of the United States gathering line total. The next ranking firm in terms of crude gathering pipeline mileage is Shell with 2,247 miles.

26. If Mobil were to acquire Conoco the combined entity would own and operate 8,541 miles of crude oil gathering pipe-

lines, representing 23.1% of the total mileage of crude oil gathering pipelines, and would control nearly four times the mileage of crude oil gathering pipelines as the next largest company. The four-firm concentration would be increased from 35% to 41%, or an increase of 17%, and the eight-firm concentration would increase from 56% to 61%, or an increase of 9%.

27. Mobil and Conoco are direct horizontal competitors in the purchase of crude oil from others to provide for their refinery operations throughout the world. In the United States, the prices paid by refiners on the lease purchases from producers are based on their posted prices for the particular area and type of crude. These price postings have quality differentials based on the specific gravity of the crude, with the lighter oils being higher priced due to their greater yield of gasoline and light distillates which produce more revenue. Conoco and Mobil compete as price posters to purchase the following different types of crude oil among others: Wyoming Sour; Wyoming Sweet; Kansas Sweet; Oklahoma Sweet; Oklahoma Sour; North Texas Intermediate; West Central Texas Intermediate; West Texas - New Mexico Sour; West Texas - New Mexico Intermediate; West Texas - New Mexico Ordovicial; and South Louisiana Sweet.

28. Crude oil prices and gravity differentials vary from field to field depending on the competition among buyers in the local area and their particular refinery needs. Refiners must watch closely the price postings of their competitors, particularly other majors who have gathering pipeline systems available to hook up to the producing properties. Because of their sizeable overlapping gathering systems, Conoco and Mobil are sometimes the dominant competing crude oil buyers in particular market areas

and are among relatively few purchasers to whom the producers in those fields can look as an outlet for their crude oil production.

29. Among the markets where Conoco and Mobil have leading positions as lease purchasers of crude oil are:

(a) The North Texas field in eleven counties surrounding Wichita Falls, Texas, where total field production is 73,000 barrels daily or approximately $932.5 million on an annual basis, where Conoco purchases 17.6% of the total output and Mobil purchases between 10% and 15%.

(b) An eleven county area in South Central Kansas where total field production is 48,400 barrels daily or approximately $613.2 million on an annual basis, where Conoco purchases 11.3% of the total output and Mobil's purchases are somewhat greater.

(c) Converse and Natrona, Wyoming where total field production is 48,471 barrels daily which, on the basis of an average price of $35 per barrel, equals $613.2 million on an annual basis, where Conoco purchases 6% of the total output and Mobil is believed to purchase a similar share.

Effects of the Proposed Acquisition

30. The effects of the proposed acquisition of Conoco by Mobil will be substantially to lessen actual and potential competition and tend to create a monopoly in the ownership of crude oil gathering pipelines in the United States and in indi-

vidual oil fields and groups of oil fields in violation of Section 7 of the Clayton Act in the following ways, among others:

(a) Actual competition between Conoco and Mobil in the acquisition or control of crude oil for transport over crude oil gathering pipelines will be eliminated, lessened or foreclosed in the United States and in individual oil producing areas of the United States.

(b) Concentration in the ownership of crude oil gathering pipelines will be increased, barriers to entry may be created, current participants in the market may be discouraged from increasing their presence by internal expansion and new entrants may be discouraged from entering by the existence of the merged entity.

(c) A market structure will be created whereby Mobil may be able to exert substantial economic power over the independent producers of crude oil by reason of its control of a substantial share of the total miles of crude oil gathering pipelines which are an essential means of transporting crude oil from the wellhead to the trunk lines through which it is ultimately carried to refineries.

COUNT THREE

(Elimination of Horizontal Competition in the Retail Marketing of Motor Gasoline)

31. Conoco repeats and realleges the allegations of paragraphs 1 through 21, inclusive, of this Complaint, as if fully set forth herein.

32. Conoco markets gasoline in 41 states through 5,605 retail outlets. In 1980 it sold 2,486,000,000 gallons which represented 2.3% of total gasoline sales in the United States.

Conoco ranks about thirteenth among all domestic marketers. Mobil is the fourth largest gasoline marketer in the United States with approximately 6.2% of the total. It has 17,425 retail outlets located in 48 states. The combined companies would rank at least third.

33. Conoco markets under its major "Conoco" brand in Louisiana, Texas and New Mexico northward through the Plains states, Rocky Mountain states and upper Midwest. In this area Conoco sells to branded jobbers who market the gasoline at retail through various service stations which they either own or lease.

34. Conoco markets directly through company owned and operated outlets:

(a) in the Southeast and Middle Atlantic states under the "Kayo" brand;

(b) in four upper Midwestern states under the "Western Stores" brand;

(c) in eight Midwestern and Southwestern states under the "Fast Gas" and "Jet" brands;

(d) on the West Coast under the "Fast Gas", "Jet", "Econo", "Aztec" and "Nugget" brands.

All of these company operated stations sell gasoline at the price level of the independents, which generally is two or three cents a gallon below the pump prices of the major company branded stations.

35. Conoco sells a substantial portion of its gasoline production (approximately 30%) to private rebranders. These rebranders generally market gasoline at retail price levels in competition with and below the prices posted by the major company outlets. Mobil has long maintained a policy of not selling gasoline to private rebranders.

36. Conoco and Mobil are substantial direct competitors in the retail sale of motor gasoline in most states. For example, in the eleven states in Petroleum Administration for Defense District 2 where Conoco sells through branded jobbers under the "Conoco" brand, its share of total gasoline sales amounts to 4.8% and Mobil's is 4.4%. Combined they would rank second with a market share of 9.2%. These states are Oklahoma, Kansas, Missouri, Indiana, Illinois, Iowa, Wisconsin, Minnesota, Nebraska, North Dakota and South Dakota.

37. The respective market shares of Conoco and Mobil in the sale of retail gasoline in a number of states are as follows:

State	Conoco	Mobil	Combined Share
Arkansas	5.6%	3%	8.6%
Idaho	10.1%	1%	11.1%
Iowa	4.8%	5%	9.8%
Kansas	3.7%	6%	9.7%
Louisiana	4.9%	4%	8.9%
Minnesota	4.8%	5%	9.6%
Montana	13.1%	2%	15.1%
Nebraska	7.2%	9%	16.2%
North Dakota	2.6%	6%	8.6%
South Dakota	2.6%	8%	10.6%
Tennessee	3.5%	5%	8.5%
Texas	3.5%	6%	9.5%
Wisconsin	3.0%	8%	11.0%
Wyoming	8.1%	6%	14.1%

In many terminal market areas throughout the Midwest, Mobil is one of the primary price competitors for Conoco. These markets include Chicago, Wood River, Illinois, the Twin Cities, Mount Vernon (Springfield), Missouri, Kansas City, Des Moines, and Omaha. In addition, Mobil is one of Conoco's primary pricing competitors in the New Orleans and Houston markets.

38. Because Conoco is an aggressive price marketer both through its branded Conoco jobbers and through its private brand company operated stations, its competitive impact in the countless markets where it competes with Mobil is substantially

greater than the percentage figures of gasoline sales would indicate. Its preservation as an independent competing factor is more important to competition than would be that of a company following a less aggressive pricing policy.

Effects of the Proposed Acquisition

39. The effect of the proposed acquisition of Conoco by Mobil will be substantially to lessen actual and potential competition and to tend to create a monopoly in the retail sale of motor gasoline in various markets and submarkets throughout the United States, in violation of Section 7 of the Clayton Act in the following ways, among others:

(a) Actual competition between Conoco and Mobil in the retail sale of motor gasoline will be eliminated, lessened or foreclosed.

(b) Concentration in the retail marketing of motor gasoline in the United States, and in various individual states and local markets will be increased, and barriers to entry may be created or increased by existence of the merged entity.

(c) Conoco will be eliminated as an actual substantial price competitor in the retail sale of motor gasoline.

(d) Conoco will be eliminated as a substantial source of supply to independent private rebranders.

(e) Mergers or acquisitions between other sellers of retail gasoline may be fostered, thus creating the likelihood of a further substantial lessening of competition.

COUNT FOUR

(Elimination of Horizontal Competition in the Refining of Crude Oil)

40. Conoco repeats and realleges the allegations of paragraphs 1 through 21, inclusive, of this Complaint, as if fully set forth herein.

41. Conoco owns and operates eight refineries in the United States, and has an aggregate operable refining capacity of 445,000 barrels per day. It is the thirtieth largest refiner in the United States with 2.5% of total domestic refining capacity.

42. Mobil owns and operates seven refineries in the United States, and has an aggregate operable refining capacity of 899,600 barrels per day. It is the seventh largest refiner in the United States with 4.6% of total industry.

43. Conoco and Mobil are and have been for some years competitors of each other in the refining of petroleum products throughout the United States and in regions thereof. Combined they would become the third largest domestic refiner with 7.1% of the industry total.

Effects of the Proposed Acquisition

44. The effect of the proposed acquisition of Conoco by Mobil will be substantially to lessen competition and to tend to create a monopoly in the refining of crude oil in the United States and in regions thereof in violation of Section 7 of the Clayton Act in the following ways, among others:

(a) Actual and potential competition between Conoco and Mobil in the refining of crude oil in the United States and in regions thereof will be eliminated, lessened or foreclosed.

(b) Concentration in the refining of crude oil in the United States and regions thereof will be increased, and barriers to entry will be increased or created.

(c) Conoco will be eliminated as a substantial independent competitor in the refining of crude oil.

(d) Mergers or acquisitions between other refiners will be fostered, thus creating the likelihood of further substantial lessening of competition.

COUNT FIVE

(Elimination of Horizontal Competition in the Manufacture and Sale of Petroleum Coke)

45. Conoco repeats and realleges the allegations of paragraphs 1 through 21, inclusive, of this Complaint, as if fully set forth herein.

46. Petroleum coke is a refined petroleum product produced at oil refineries equipped specially to process it. In terms of coke producing capacity Mobil ranks as the nation's largest producer with 13% of total U.S. capacity. Conoco ranks thirteenth with 2.3% of the total.

47. There are three distinct types of petroleum coke: (1) regular-grade low sulfur petroleum coke which is used in the manufacture of aluminum; (2) regular-grade high sulfur petroleum coke which is used as an industrial fuel; and (3) premium-grade petroleum coke which is used in the manufacture of graphite electrodes for electric arc steel furnaces.

48. Conoco is a significant manufacturer of regular-grade low sulfur petroleum coke. In 1980 Conoco produced approximately 180,000 tons of regular-grade low sulfur coke, which accounted for approximately 5% of the total domestic production.

49. Mobil is also a significant manufacturer of regular-grade low sulfur petroleum coke. In 1980 Mobil produced approximately 15% of the total domestic production of regular-grade low sulfur petroleum coke.

50. Conoco has announced plans for the construction of a manufacturing facility at its Lake Charles refinery to convert residual fuel oil into regular-grade petroleum coke. The facility, scheduled for completion in 1984, will have an annual production

capacity of 640,000 tons of regular-grade coke which, depending on the feedstock's sulfur content, can be used either in the manufacture of aluminum or as an industrial fuel. It would increase Conoco's share of total industry capacity to 5.5%.

51. The manufacture of regular-grade low sulfur petroleum coke is concentrated, with the four largest producers accounting for approximately 53% of total domestic production.

52. Conoco is the dominant domestic producer of premium-grade petroleum coke. In 1980, Conoco manufactured approximately 180,000 tons of premium-grade petroleum coke domestically, which accounted for approximately 80% of the total domestic production.

53. A substantial amount of expertise and know-how is required to manufacture premium-grade petroleum coke. The product is highly specialized and quality is the essential element; accordingly, purchasers generally purchase only from those companies with a recognized level of expertise in the manufacture of premium-grade petroleum coke.

54. Mobil does not presently manufacture premium-grade petroleum coke domestically although it has manufactured premium-grade coke at its Torrance, California refinery. Because of Mobil's substantial coking facilities, it could become a significant manufacturer of premium-grade coke if it had the expertise, know-how and reputation for manufacturing premium-grade petroleum coke that Conoco enjoys.

55. Conoco has announced plans for a phased expansion of its premium-grade petroleum coke manufacturing facilities at its Lake Charles refinery. Upon completion of the first phase the refinery's annual premium-grade coking capacity will be increased by 48,000 tons to 238,000 tons.

Effects of the Proposed Acquisition

56. The effects of the proposed acquisition of Conoco by Mobil will be substantially to lessen actual and potential competition and to tend to create a monopoly in the manufacture of regular-grade low sulfur petroleum coke and premium-grade petroleum coke in the United States in violation of Section 7 of the Clayton Act in the following ways, among others:

(a) Actual competition between Conoco and Mobil in the manufacture of regular-grade low sulfur petroleum coke in the United States will be eliminated, lessened or foreclosed;

(b) Concentration in the manufacture of regular-grade low sulfur petroleum coke in the United States will be increased and barriers to entry may be increased or created by the existence of the merged entity;

(c) Conoco's already dominant position in the manufacture of premium-grade petroleum coke will be entrenched as a result of Mobil's coking capacity.

COUNT SIX

(Elimination of Competition for the Acquisition of Foreign Crude Oil)

57. Conoco repeats and realleges the allegations of paragraphs 1 through 21, inclusive, of this Complaint, as if fully set forth herein.

58. Both Mobil and Conoco are substantial purchasers of crude oil on the world market for shipment to and consumption in the United States.

59. There is a world-wide cartel of oil producing countries known as the Organization of Petroleum Exporting Countries ("OPEC"). The OPEC countries maintain a 77% share of

non-Communist world oil reserves. Chief among these OPEC countries is Saudi Arabia which has the power, by virtue of its vast reserves and productive capacity, to exercise control over the world price of oil by increasing or decreasing production. Saudi Arabia's activities as a major OPEC member and the world's largest exporter of crude oil have a direct and substantial effect on prices for crude oil in the United States.

60. The Arabian American Oil Company ("ARAMCO") is a firm that is jointly owned by Exxon, Mobil, Texaco and Standard of California, the four largest integrated oil companies in the United States. Under concessions granted by Saudi Arabia, ARAMCO is by far the world's largest oil-producing corporation.

61. Because Saudi Arabia is the world's largest oil producing country, Mobil, and the other ARAMCO partners, enjoy market power far greater than their individual market shares might indicate. The only effective counter to this market power is the effective competition by Conoco and other companies which produce or purchase oil in the world market. The acquisition of Conoco by Mobil will weaken the competitive position of the independents.

Effects of the Proposed Acquisition

62. The effect of the proposed acquisition of Conoco by Mobil will be substantially to lessen actual and potential competition and to tend to create a monopoly in the market for the production and sale of crude oil in violation of Section 7 of the Clayton Act in the following ways, among others:

(a) Actual competition between Conoco and Mobil and the other ARAMCO partners in the acquisition of crude oil will be eliminated, lessened or foreclosed.

(b) The ability of Saudi Arabia to control the world price of oil will be enhanced.

COUNT SEVEN

(Elimination of Horizontal Competition in the Production and Marketing of Coal)

63. Conoco repeats and realleges the allegations of paragraphs 1 through 21, inclusive, of this Complaint, as if fully set forth herein.

64. Because of the world-wide energy crisis, coal has become a much more highly valued and potentially critical resource, both as a direct source of energy and as a raw material. The United States is one of the richest areas of the world in proven coal reserves.

65. Conoco, through its subsidiary Consolidation Coal Company, is the second largest coal producer in the United States and the largest holder of proven reserves.

66. Mobil is currently developing a surface coal mine in Wyoming and has proved and probable reserves of 4,135 million tons located primarily in the Western United States and in Illinois. Mobil's coal reserves are substantially larger than most of the largest coal producers in the United States. Conoco's coal reserves as a percentage of total domestic reserves are 5.6% and Mobil's are 1.6%. A combination with Conoco would give Mobil control over an undue percentage of this country's vital coal reserves.

67. The Northern Plains, consisting of the States of North Dakota, Wyoming and Montana, is recognized by the Department of Energy, the Department of the Interior, the Department of Justice and others, as a separate geographic market or submarket for coal.

68. Conoco presently has approximately 13.9% of the proven reserves of coal under federal coal leases in the Northern Plains market. Upon information and belief, Mobil has sufficient reserves in the Northern Plains market to account for at least 5% of the proven reserves of coal under federal coal leases.

Effects of the Proposed Acquisition

69. The effects of the proposed acquisition of Conoco by Mobil will be substantially to lessen competition and to tend to create a monopoly in the production and marketing of coal in violation of Section 7 of the Clayton Act in the following ways, among others:

(a) Actual competition between Mobil and Conoco in the production and marketing of coal will be eliminated, lessened or foreclosed in:

(i) the United States;
(ii) the Northern Plains, and/or
(iii) Wyoming and other states.

(b) Potential competition between Mobil and Conoco in the production, marketing and sale of coal will be eliminated, lessened or foreclosed in:

(i) the United States;
(ii) the Northern Plains, and/or
(iii) Wyoming and other states.

COUNT EIGHT

(Elimination of Horizontal Competition in the Exploration for and Production of Uranium)

70. Conoco repeats and realleges the allegations of paragraphs 1 through 21, inclusive, of this Complaint, as if fully set forth herein.

71. Conoco is engaged in the exploration for and production of uranium in the United States, as well as in other countries. As of December 31, 1980, Conoco held 389,458 acres of uranium prospecting lands in nine states.

72. Conoco conducts part of its uranium business through joint ventures or partnerships, and part independently:

(a) Conoco owns a two-thirds interest in the Conquista uranium mine and mill in Texas.

(b) Conoco has a one-fourth ownership interest in the Benavides uranium project in Duval County, Texas. In situ leaching commenced at this project in February 1980.

(c) Conoco has entered into a joint venture with a subsidiary of Westinghouse Electric Corporation to develop Conoco's uranium deposits near Crownpoint, New Mexico.

73. Conoco has a strong reserve position in uranium reserves. Conoco estimates its reserve holdings at approximately 61 million pounds which is 5.5% of domestic recoverable uranium concentrate reserves.

74. Mobil has acquired significant reserves of uranium, and is exploring actively for uranium in the United States, principally in Texas and New Mexico, and in Canada and Australia. Mobil also has developed leaching technology for the production of uranium.

75. Mobil has approximately 36 million pounds of recoverable uranium concentrate reserves in this country and accounts for 3.3% of the total domestic reserves.

76. Concentration in the ownership of recoverable uranium concentrate reserves is moderately high. The four largest firms account for approximately 35% of the total U.S. reserves, and the eight largest account for approximately 55%.

77. If Mobil were to acquire Conoco the combined entity would own approximately 97.2 million pounds of recoverable uranium concentrate reserves and account for approximately 8.8% of the total U.S. reserves. The four-firm concentration in the ownership of domestic reserves of uranium would increase from 35% to 39%, or an increase of 11%, and the eight-firm concentration would increase from 55% to 59%, or an increase of 7.7%.

Effects of the Proposed Acquisition

78. The effects of the proposed acquisition of Conoco by Mobil will be substantially to lessen actual and potential competition and to tend to create a monopoly in the ownership of uranium reserves in the United States in violation of Section 7 of the Clayton Act in the following ways, among others:

(a) Actual competition between Conoco and Mobil for the acquisition or control of uranium reserves will be eliminated, lessened or foreclosed in the United States.

(b) Conoco will be eliminated as an independent competititve entity engaged in the acquisition of ownership or control of uranium reserves.

(c) Concentration in the ownership of uranium reserves will be increased, barriers to entry may be created, current participants in the market may be discouraged from increasing their presence by internal expansion and new entrants may be discouraged from entering by the existence of the merged entity.

VI. IMMEDIATE AND IRREPARABLE INJURY

79. If Mobil is not temporarily, preliminarily and permanently enjoined and restrained from carrying out the pending offer to purchase Conoco stock, the public interest will be injured in the following ways, among others:

(a) Competition will be eliminated, lessened or foreclosed, and a monopoly may tend to be created in violation of Section 7 of the Clayton Act, in the following lines of commerce, among others: the exploration for, production, acquisition and transportation of crude oil; the refining of crude oil; the sale of refined petroleum products including motor gasoline, distillate fuel oil, diesel fuel and petroleum coke; the operation of natural gas processing plants and the sale of natural gas liquids; and the acquisition and sale of uranium and coal.

(b) Concentration in those product categories will increase and the tendency toward concentration strengthened; and

(c) Barriers to entry in those industries will be created or increased.

80. If Conoco is not provided with the temporary, preliminary and permanent injunctive relief requested, Conoco and its shareholders will suffer immediate and irreparable harm in the following ways, among others:

(a) Conoco will be injured in its business operations by reason of the violations of Section 7 of the Clayton Act:

(b) Conoco's business and its relationships with customers and employees will continue to be jeopardized by the uncertainties generated by the pendency of the Mobil tender offer;

(c) Conoco's separate identity and current competitive status is being and will continue to be damaged such that it could never be completely restored;

(d) Conoco will experience great difficulty in hiring and retaining officers and employees to the detriment of present and future corporate administration;

(e) Conoco and its shareholders have already been and will continue to be subjected to litigation challenging the legality of the proposed merger, or arising by reason of Mobil's tender offer, and may be subjected to potential treble damage liability because of the illegality of the proposed merger;

(f) The assets and operations of Conoco and Mobil will become commingled, thus making it impossible to restore Conoco fully to its present independent status if the proposed merger is eventually held to be illegal;

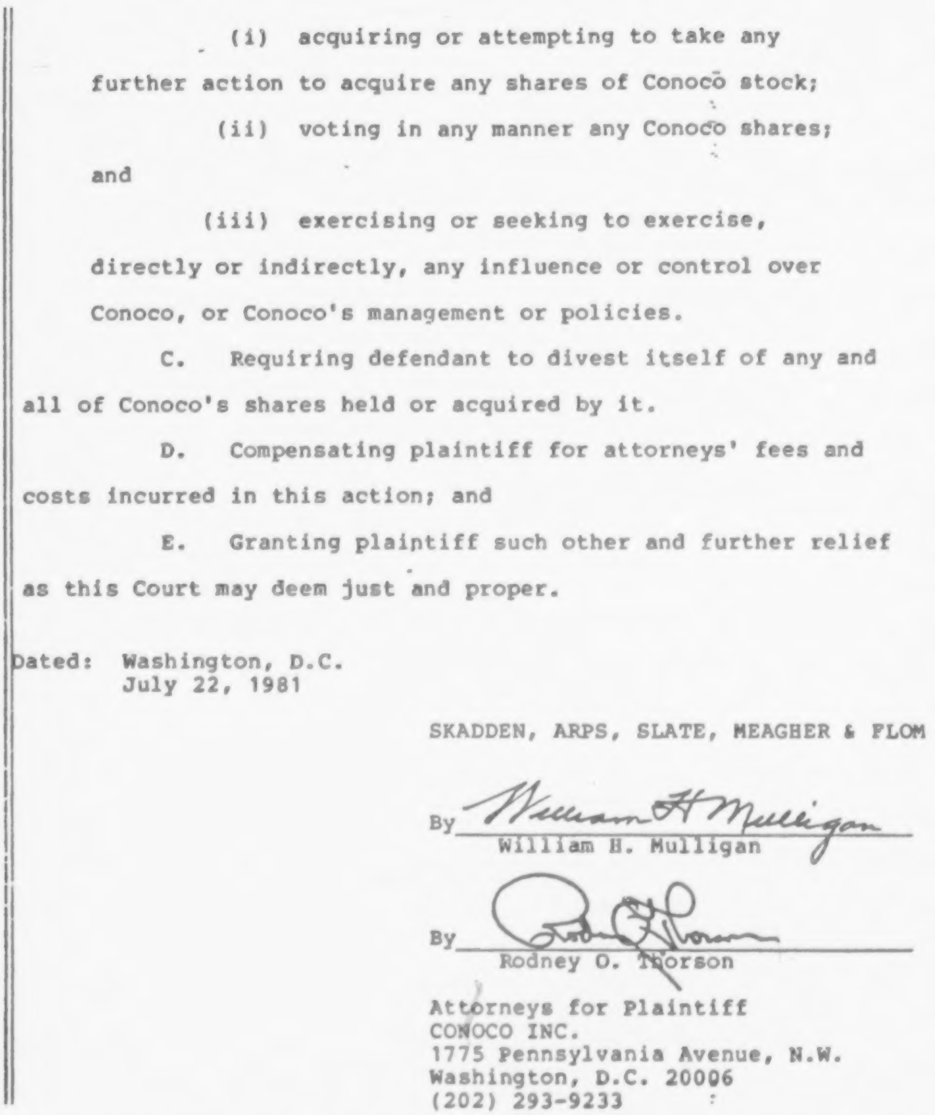
(g) Mobil will acquire a "listening line" to Conoco's trade secrets, business strategies and confidential business operations, thereby affording Mobil an unfair and significant competitive advantage over Conoco even if Mobil is able to divest Conoco if the proposed merger is later found to be illegal.

PRAYER FOR RELIEF

WHEREFORE, plaintiff respectfully prays for judgment as follows:

A. Declaring that the acquisition of Conoco by Mobil violates Section 7 of the Clayton Act.

B. Enjoining defendant, its agents, servants, employees and all persons acting on its behalf or in concert with it temporarily, preliminarily and permanently, from:



(i) acquiring or attempting to take any further action to acquire any shares of Conoco stock;

(ii) voting in any manner any Conoco shares; and

(iii) exercising or seeking to exercise, directly or indirectly, any influence or control over Conoco, or Conoco's management or policies.

C. Requiring defendant to divest itself of any and all of Conoco's shares held or acquired by it.

D. Compensating plaintiff for attorneys' fees and costs incurred in this action; and

E. Granting plaintiff such other and further relief as this Court may deem just and proper.

Dated: Washington, D.C.
July 22, 1981

SKADDEN, ARPS, SLATE, MEAGHER & FLOM

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William H. Mulligan

By
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Senator METZENBAUM. Mr. Flynn, you challenge the basic assumptions underlying the Department of Energy, title III, report. Could you elaborate?

What specifically do you believe are the report's major misconceptions?

Mr. FLYNN. First, in the net-back studies that were done, they excluded fixed costs. I do not know of any businessman who excludes fixed costs in deciding what cost is. The preliminary studies did that.

Second, they also were operating on figures produced during the time when we had controls. I think that may have been misleading.

Third, the study—and this is a little bit philosophical—set up a model and analyzed the model and not the facts that the model was intended to illuminate. I call that a case of seeing the light and not the facts the light is intended to illuminate.

Finally, again, the problem here primarily today is a case of predatory costing and not predatory pricing. They were looking in the opposite direction for something that may or may not have existed in those circumstances. They could not find it, which does not surprise me.

Senator METZENBAUM. One last question.

There is nothing really very novel about this question of prohibiting oil companies from owning their own stations.

We have it now by prohibiting meat packers from entering into retailing. Is that correct?

Mr. FLYNN. That is the result of a very old antitrust decree; yes, Senator.

Senator METZENBAUM. And the motion picture producers are prohibited from operating theaters?

Mr. FLYNN. That is correct.

Senator METZENBAUM. Are there some other areas where one part of the industry is prohibited from also being involved in the retailing part of the industry?

Mr. FLYNN. As a practical matter, and this ought to be understood, I do not know of any industry where companies vertically integrate like this. What the oil companies are doing is very unusual.

Rather than assuming that they should be treated as acting competitively or rationally in doing it, it is really strange that a major oil company would vertically integrate into retailing in every corner in the country.

In answer to your question, the places where it has happened, usually indicate that there is some translation of market power from one level to the other. Usually that has brought about a massive antitrust response in the past. You have meat packing and motion pictures.

We have done it by legislation, both horizontally and vertically, elsewhere—in commercial banking and investment banking, for example; in the Public Utility Holding Company Act; and, strangely enough, in the deregulation movement.

I do not think I am talking out of school to say that I have talked with some people in the electric power industry about the wisdom of vertical dissolution in the electric energy industry, breaking off the production end from the distribution end because the production end is now competitive and the distribution end is not.

When you have that relationship going on, you get an abuse taking place.

There have been antitrust decisions in the *Otter Tail* case and the *City of Mishawaka* case in the electric power industry. There was essentially an attempt to prevent the use of monopoly power at one level from doing what we are seeing happening in the oil industry.

Vertical dissolution is not an uncommon thing. It is far more common than most people realize.

Senator METZENBAUM. I thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator East?

Senator EAST. I have no questions, Mr. Chairman.

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Mr. Chairman, I have questions of the next witness, but not of this one.

The CHAIRMAN. I would like to ask you this.

Will the public be best served if this bill is passed or not passed?

Mr. FLYNN. I think it will be served if it is passed.

The CHAIRMAN. As the Senator from Ohio mentioned a few moments ago, we are interested, of course, in the filling station people. We are interested in the jobbers and the oil companies and everybody who runs a business.

However, our primary duty is to the public as a whole.

Mr. FLYNN. Correct.

The CHAIRMAN. That is our highest duty.

Is it your opinion that the public would be best served if this bill passes?

Mr. FLYNN. Yes, Senator, without any reservation.

The CHAIRMAN. Would you recommend its passage as it now has been introduced, or do you wish to think over some amendments to present?

Mr. FLYNN. Again, Senator, I think there is a dialog going on about the rack pricing provisions. I support them as they are presently written. I confess to being somewhat ignorant of how they might impact on jobbers.

I think the dealers do not want to engage in practices necessarily that injure jobbers and in ways that are unjust or unfair.

Given some time to reflect and get some greater factual background on how the bill might impact on jobbers and the rack pricing provision, I think I would support the bill as it is presently written.

The CHAIRMAN. I would like to ask you this question which is not before us now, but the Senator from Ohio brought this out. The producers are not allowed to run picture shows, and meat packers are not allowed to operate retail places.

Would the public be best served if oil companies are not allowed to own their own stations?

Mr. FLYNN. Yes, Senator.

The CHAIRMAN. The public would be best served?

Mr. FLYNN. Yes, Senator.

The CHAIRMAN. That is your opinion.

Mr. FLYNN. That is my opinion.

I can elaborate on it, but I do not want to chew up too much of your time.

I had a recent experience, last Tuesday, of attending a city council meeting where a number of people in a neighborhood were trying to get a zoning law changed so that a retail gasoline dealer could operate a repair service in the neighborhood without selling gasoline. It was surprising, because normally most neighbors do not like to have that kind of operation in their neighborhood.

These consumers were very upset, because they found they could not get convenient repair services in their neighborhood any longer, since most of the stations had been closed down by the major oil companies.

The only thing left were glass bullet-proof booths where you pay someone, pump gas yourself, and there is no service.

The CHAIRMAN. Which would be cheaper to the public in the sale of gasoline?

Maybe some people would rather just buy gasoline at the cheapest price and others would want repair service and maintenance and those things.

Mr. FLYNN. In Utah, we have the highest percentage of market of self-serve. I think about 81 percent of the gallonage in Utah is pumped self-serve.

That can take place at a full-service station or at a dealer-operated pumper, and so on. There is no magic about the fact that the station is owned by a major oil company so that it can be a pumper. Dealers run pumpers. In fact, I think, historically, they started the practice.

You could get the same cheap price on pumping your own gasoline. There is no problem with that at all.

What is happening is that we are gradually seeing—like Henry Ford used to do—that you can have any kind of Model-T so long as it is black. You can have any kind of gasoline station in some areas of Salt Lake City right now so long as it is a pumper owned by a major oil company.

The variety of different services is not available as dealers are being terminated.

The CHAIRMAN. Do you have any other questions, Senator Metzenbaum?

Senator METZENBAUM. No, Mr. CHAIRMAN.

The CHAIRMAN. Thank you very much.

Mr. FLYNN. Thank you, Senator.

The CHAIRMAN. Our next witness is Mr. Robert S. Campbell, Jr., of Salt Lake City.

Mr. Campbell, you may proceed.

STATEMENT OF ROBERT S. CAMPBELL, JR., WATKISS & CAMPBELL, SALT LAKE CITY, UTAH

Mr. CAMPBELL. Thank you, Mr. Chairman and members of the committee.

My name is Robert Campbell. I am a lawyer engaged in the practice of law in Salt Lake City.

In my 24 years of trying lawsuits, I have been principally engaged in complex economic litigation. In the course of that practice, I have represented small retailers and jobbers and some oil companies, in both antitrust matters and litigation and on both sides.

At the present time, one of the major cases that I have pending in Utah is a case in which I represent a position against one of the largest major oil companies. It involves some very serious antitrust questions.

I appear before the committee this morning not on behalf of or as a representative for the industry or for any oil company or any jobber or dealer. I have paid my own way here, because of the interest I believe that this particular bill has to the public at large and to the public interest.

Mr. Flynn is my good friend. John and I agree on a number of things.

If we were to talk about the Conoco complaint that was filed this morning, I think you would find unanimity between the two of us as to the attempt by Mobil to take over Conoco.

I appear here, hopefully, as an objective witness. My experience and review of the retail market in the oil industry has come both as a practitioner and as an academician.

At Oxford University in England some year and a half ago, I spent 8 months in review of the problems in the petroleum industry in the context of antitrust and competition policy. I wrote a thesis which has been published in the United States and also in Europe with regard to antitrust divestiture in the petroleum industry in both the United States and the United Kingdom.

Mr. Chairman, I have presented to the committee a prepared statement. It is not nearly as long as my friend John's is, but it is some 25-plus pages, along with an accompanying biographical vitae which I would submit to the committee and ask that it be made a part of the record of these proceedings.

The CHAIRMAN. Do you desire for your entire statement to go in the record and then you wish to summarize it?

Mr. CAMPBELL. Yes; I do.

The CHAIRMAN. Without objection, that will be done.

Mr. CAMPBELL. Thank you, Mr. Chairman.

I believe the ultimate question before the committee under S. 326 does not depend upon the language or whether you happen to be in favor of large, major integrated oil companies or in favor of small independent retailers.

I think the stakes are higher than that, and they are more fundamental.

ANTICOMPETITIVE NATURE OF S. 326

The issue here is simply the harm that the bill will do to the basic concept of competition in a free market under the existing antitrust laws of the United States, as well as the impact it will have on actual competition and the competition system in this country.

What the bill essentially says is that there are certain portions of the retail market presently existent which will no longer be able to compete in the market.

They will not be able to compete in the market not because they have engaged in predatory pricing or because they have engaged in other anticompetitive or exclusionary conduct to drive out the small retailer but rather because——

The CHAIRMAN. Excuse me just a minute. This will be off the record.

[Off-the-record discussion.]

I will ask Senator Hatch to take over. If he leaves, Senator Grassley will take over until I get back.

Just proceed with your statement.

Mr. CAMPBELL. Thank you, Mr. Chairman.

The bill is fashioned upon the premise that competitors presently in the market will be blocked and obstructed from participation, because they simply are too big and because they have a refining capacity that in a given year—1978—may exceed 175,000 barrels of oil per day.

The bill, in my judgment, is anticompetitive in its obsession with size, and anticompetitive because of the effect that it has upon the positive aspects of competition.

First, there are the benefits of vertical integration that are and should be at play in any industry, whether it is a large oil company or a smaller one—whether it is a jobber who only has one chain of distribution and geographic area or whether it has them throughout several States.

Second, the bill in my judgment ignores the practical realities of the petroleum industry. That is that there is a natural process and flow in taking oil out of the ground and putting it in a pipeline to take it to the refinery and putting it in the tank or wagon for delivery to retail stations and ultimately for sale at the retail gasoline level to the general public.

There is an almost natural kind of economic force that suggests that integration is a normal way of doing business and not a tool to drive out your competitor.

The bill, as I understand it, would arbitrarily say to some 16 companies, regardless of what the findings are on the merits as to those 16 companies regarding the nature of their competition, whether or not they competed in good faith, whether or not in any geographic markets or on a national level they have competed fairly and have done so in the public interest, that simply by reason of their size of refining capacity they cannot do business any more at the retail level.

That is the basic problem that hangs up this bill.

It is what many would call—and what Mr. Flynn is one of the advocates of—no-fault antitrust.

That is to say that regardless of what you have personally done in the marketplace, if you are too big or if you do not happen to meet the criteria of the people who are determining the fate of the market at that time, you cannot compete. You are blocked out.

Competition in the retail market has been reasonably brisk. I am not here to suggest, nor do I believe that I am qualified to say, that it has been intense in the sense that there have been price wars—we have all seen them at various times—nor what the causation has been from time to time.

Rather, the competition has been brisk. We are dealing with a highly unconcentrated market.

Mr. Flynn has asked for the market shares. I will trot them out. I have done so in my testimony on a national level.

We are looking at a very unconcentrated industry, at least at the retail market level.

UNCONCENTRATED INDUSTRY

This, as you will note, makes its way also into the refining market and the production market.

They are relatively low market shares of the leading major companies which would be most impacted by the bill.

As I recall, in 1978 or thereabouts, Amoco and Shell were the market leaders nationally with something less than an 8-percent market share.

All of the major integrated companies that would be affected by S. 326 have lost market share in the last 8 years. Something in the range of about 6-percent national market share to smaller independents, both in the refining industry, or marketing tier, as well as in the retailing end of the business.

It is claimed by John and others, and I think John is correct in some respects, that it is not national market shares we are interested in; it is local market shares.

The relevant geographical market is either on a community basis or a statewide basis.

Anybody who has been involved in antitrust litigation for any length of time knows the first tool of the antitrust litigator/prosecutor is to define as narrowly as he can a relevant geographic market.

If you can keep it within a four-square-block area, you can turn a very fierce competitor into a monopolist, can't you—if he happens to be the only service station in that four-block area.

If we wish to talk about relevant geographic markets, we need to take a specific look before this committee as to what markets are directly involved.

If the issue is national market shares, one cannot make an argument of monopolization or dominance by any company or of a shared monopoly in that market.

I would say by way of demurrer, in response to the claim that markets are geographic and small in size, much less than national on a State or a community level, that if that is a local problem, it ought to be left to the local States to handle the problem and not by way of national legislation.

The better argument as well is that if there is a local problem of predatory pricing by a major company—in Salt Lake City or Washington, D.C., or parts of any particular geographic market, whether Cincinnati or Fort Wayne, Ind.—that is a very specific problem for the Antitrust Division of the United States.

The Sherman Act is precisely designed to take care of predatory pricing and other anticompetitive behavior that drives small independent dealers out of the market.

I would defend to the best of my ability any dealer whose position has been unfairly obstructed in his ability to compete in the marketplace. If that happens, he ought to have full recourse to the antitrust laws for his remedy.

VERTICAL INTEGRATION

The bill, in my judgment, would eliminate the efficiency of integration that comes from combining the resources of a company at various marketing tiers. The market would be less efficient if, in fact, the integrated refining company were unable to sell at a retail level for less than what he would if he were not in the refining business.

The integrated oil company argues that it can achieve cost economies through vertical integration. If there is some evidence to the contrary, that is the basis for an antitrust case, whether the case is against Exxon or Mobil or Conoco, or whoever it is. If they are engaged in predatory pricing, they ought to be brought to bear.

To use Professor Flynn's suggestion, if it is in an area where there is significant concentration, then that company ought to be subject to a Sherman 2 count as well as Sherman 1, not only for predatory pricing but for monopolization.

It may well be that divestiture would be the best remedy under the specific circumstances.

Divestiture is on a case-by-case basis.

As it was suggested this morning, the theater industry is under a decree where certain specific producers cannot own retail theater operations, that is as a result of a specific case. It is not, however, an industrywide statute that has been passed by Congress which arbitrarily says that if you are too large, you cannot further compete in this business.

If you keep your refining capacity down low enough, we will let you go ahead and compete. You can still engage in whatever sort of pricing you want. It may still have a deleterious effect upon the retail competitor. However, in fact, we are not going to say that as a matter of statutory mandate from the Congress of the United States that you will be unable to compete.

I would like to engage in the same sort of dialogue that Mr. Flynn was talking about.

ANTITRUST ENFORCEMENT

In summation, I think it is important for the committee to reflect upon the fact that we have in existence in this country the toughest antitrust laws in the world. People go to jail for violating the antitrust laws. They pay stiff fines of up to $1 million for each offense.

There is a treble damage remedy. There are attorney fee remedies. No other country in the world protects competition like this committee has, pursuant to the Sherman, Clayton, and Robinson-Patman Acts.

What I suggest to the committee is that we make sure that those acts are utilized.

If there is the predatory pricing going on which I have heard about in the committee this morning, then I suggest that that is a job for the Department of Justice and for the individual States through their local attorneys general to bring forward actions that eliminate predatory pricing. It is one of the most diseased areas of antitrust.

If that is the fact, it should be stopped.

On the other hand, to simply arbitrarily say that we are going to tell you people that because, No. 16, you happen to have more than 175,000 barrels per day and you are buying less than 70 percent of your refined product from other sources, we are going to say that you cannot compete—only because of that, even though you may be a very strong competitor and you may have helped the market.

It is the arbitrary aspect of the bill that I believe is the downfall of it and is the most serious disabling provision.

NO-FAULT ANTITRUST LIABILITY

As I said, it is really the beginning of what I see as the prospect of no-fault antitrust law.

I know Mr. Flynn is a spokesman for that. I do not happen to believe in it. I happen to believe that the free market should determine on a case-by-case basis those who compete and those who compete well and those who do not compete and those who compete in an anticompetitive or exclusionary way.

Those folks ought not to do business. We ought to see to it that that is the case.

We have some of the best laws in the world to take care of it right now.

With respect to the other provisos in the bill—the daily wholesale transfer price—that is a question that I believe ought to be handled and left to the Robinson-Patman Act right now.

We have a price discrimination provision in the antitrust laws, but it is tied to the fact that you have to make a showing that that price discrimination has had an effect upon competition or has tended to create a monopoly.

S. 326 simply says that you cannot under any circumstances, no matter what the justification is, even if it is in good faith competition, sell gasoline for a price less than the daily wholesale transfer price.

It is the arbitrary nature of the provision that I think bothers most antitrust practitioners which has made its way into this bill.

It would outlaw any short-term changes in the market, even though made in the best interest of the public to get to the consumer ultimately the best product at the lowest possible price.

The open supply provision of section 3 of S. 326 is one that I have somewhat less concern about than the divorcement provisos of the bill.

It is, however, also bothered by the same axiomatic arbitrary aspects requiring no interference with the retailer and regardless of the circumstances.

I suppose if you had been dealing with a retailer and if section 2(c)(1) of S. 326 were enacted, if you were to deal with the retailer and thereafter say, I am not going to be able to sell your product today, that could be a violation of that law. It is to broad in its sweep as to what might fit within the violation of the open supply proviso.

Again, Mr. Chairman, it is a no-fault provision. It does not have anything to do with the reality of the world and what is happening in the local market—whether it is local, a larger statewide market, or whether it is a national market.

EXCLUSIVE DEALING

On the exclusive dealing provision in the exception to section 2(c)(1) of the bill:

In my judgment, it makes an exclusivity supply contract illusory.

The reason it does is that it does not allow both the retailer and the refiner to depend on each other. The retailer can depend upon the refiner, but the refiner cannot depend upon the retailer as a source of outlet.

There are definite procompetitive aspects of exclusive dealing agreements. Most people, I think, will recognize that fact—on both sides, for both the dealer and the retailer.

Under the bill if the retailer finds that he can buy at a lower price, he can get out of the contract. The supplier or the refiner is stuck with it regardless. He must supply for that period of time.

As I say, it makes the contract not only one-sided but also illusory. And it probably makes it unenforceable.

I have some concerns about long-term exclusive supply agreements in the petroleum industry. I think that does present a problem that is, on balance, anticompetitive. It perhaps puts the retailer at a disadvantage with the oil company.

I am talking about a 5-year exclusive supply agreement where he has to take all of his product from the refiner at that time.

But a 1-year or 2-year exclusivity agreement may not be anticompetitive depending upon the circumstances and surely should not be caught necessarily within the framework of a bill which, as a matter of a wholesale industrywide basis, simply says that a retailer can get out of the exclusive agreement anytime he wishes.

I would say in closing, Mr. Chairman, that I appreciate the opportunity of being here.

I think it is extremely dangerous business we are talking about here this morning to eliminate with an almost meat-ax technique an entire segment of the industry and tell people they can no longer compete in a market.

The bill is dependent upon and makes the size of a company the basis upon which a man can compete in the marketplace, rather than his actual day-to-day performance in the market.

It seems to me that once you start down the road of an industry being subjected to no-fault antitrust, we can do the same thing with the jobbers.

There was a question asked by the chairman this morning, I believe, about the jobbers and how we can protect them.

LEGISLATIVE MARKET DEFINITIONS

I do not think this committee can sit here, no matter what the infinite wisdom is of this honorable body, and restructure an industry to take care of everybody. It seems to me that we have to do it on a case-by-case basis, based upon the competitive exigencies in the marketplace in that particular set of circumstances.

If we do attempt by way of no-fault antitrust to carve up into bits the portions of the refining and retailing industries, we can then do that with almost any industry.

I believe it sets an extremely bad precedent, and, as I say, it is very dangerous business.

I think that there is an economic argument made that higher profits will result at the retail level to the detriment of the consuming public as the result of an entire divorcement. I certainly think that in individual circumstances, you can make the case that there may be lower prices in given circumstances to the general public.

The price at the end of the line is a relevant factor surely in setting antitrust policy.

I do believe that S. 326 is radical surgery which is unneeded and which is now fully taken care of by the antitrust laws that we have on the books and that are fully enforceable if we will turn to them and use them.

Thank you, Mr. Chairman.

Senator **Hatch** [acting chairman]. Thank you, Mr. Campbell. I want to apologize to both of you and to the other witnesses for not being here this morning, but I have been conducting Labor and Human Resources Committee hearings upstairs.

Let me just ask a couple of questions, and I know that Senator Metzenbaum and Senator Grassley will have some also.

MONOPOLIZATION IN THE RETAIL MARKET

There has been discussion about the monopolization of the gasoline business by major refiners today, and about which this bill certainly pertains.

What kind of market share do these refiners have? In your opinion, is that share enough to create a monopoly to justify this bill?

Mr. **Campbell**. On a national basis, I do not think anybody makes the claim that there is sufficient market share for dominance, much less a monopoly.

In certain geographic markets, there may be sufficient market power and market dominion.

That is the whole point of the matter, Mr. Chairman. It is the fact that we have to look at the individual facts, specifically, in each geographic market to determine whether or not there is a highly concentrated market in that particular area.

In the area Mr. Flynn and I are both acquainted with, in Utah, there is not a dominance by one refiner of such a magnitude as to constitute a monopoly or what I perceive to be a violation of section 2 of the Sherman Act for monopolization.

It could happen. If it does happen, it ought to be stopped.

Senator **Hatch**. In your testimony, you favor the traditional antitrust approach to pricing violations. Do you think those who have been victimized in the past have found a reasonable remedy in the courts?

Mr. **Campbell**. When you say "reasonable remedy," that is a difficult problem. It takes a great deal of time to litigate antitrust cases unfortunately. We have abuse of discovery, and we take longer than we should to get cases to trial.

If that is the case, and I think there can be an argument made that it does take too long to get to trial, that should not be laid as an indictment at the foot of the oil companies. That is a problem that we all have, no matter whether we are retailers in selling gasoline or whether we are selling ball bearings or bubble gum. You have the same problem.

I do believe that there is an effective remedy.

State antitrust laws now are almost parallel in every State I know of to those of the Sherman and Clayton Acts.

The State attorneys general are now much more active in the field of antitrust enforcement than they have been in the past.

What needs to be stopped, by adoption of civil remedies of treble damages, is the practice of predatory pricing.

If that is actually ongoing and can be proven, it should be stopped at the local level in the local market.

Senator **Hatch**. Mr. Flynn, let me just ask you a question.

In your testimony, you state that exchange agreements eliminate competition. Since S. 326 is a retail divorcement bill, how would it, if passed, promote competition at the refinery level?

Let me just add these comments: It seems that major refiners are already competing through their own stations, whether they are stop and go outlets or whether they are branded stations created specifically for the vertical integration you have been speaking against.

Cannot stations like Bonanza, Rainbo, Double Kwik, and Maverick compete just as well with stations like Texaco, Gulf, Shell, and Conoco?

Mr. **Flynn**. Compete just as well in what sense, Senator?

Senator **Hatch**. In the sense that you are speaking about in saying that there is no competition.

Mr. **Flynn**. The exchange agreements I was referring to are a widespread practice between refiners and major companies also retailing in the area.

If you do not have capacity in a particular area to supply your branded outlet, what a company would do would be to enter into an exchange agreement whereby the local refiner, another major usually, would provide product in exchange for doing the same thing for the branded stations of the local refiner elsewhere in the country.

When you have two majors doing that, I think that is different than having independent companies competing against each other at the retail level. Essentially, they are fixing the wholesale price. That is where I see the dilemma is.

PROBABLE NEW ENTRY INTO THE RETAIL MARKET

Mr. **Campbell**. I think one of the dangers we may face under a proposed divorcement of the entire industry from the retail level is that we will have other large, well-financed, well-heeled, well-capitalized but smaller refiners come into the market and buy up the retailing end of the business from the majors that have had to go out as a result of S. 326. We will find ourselves with another oligopoly at the retail level, only they will be even less sensitive to the needs of the small retailer and the small private businessman which I favor as much as anybody sitting at the table this morning.

I think that there is a substantial danger that the attempt to excise by legislation the large majors may only be a forerunner or a vanguard of the entry into the market of other well-financed but smaller refiners.

When you stop at the 175,000-barrel level, and you take the first 16 companies, there still are a number of companies left that have sales of over $1 billion a year that are highly capitalized and could come into the retail market and pick up those positions.

In doing so, they present the same problem to the individual retailer that is now claimed is the thrust and object of S. 326.

Senator HATCH. Mr. Flynn, you cite Maryland as an example of a State where divorcement and low prices exist together. Then you say that there is no significant refining in Maryland. We all know that there is refining very close or near Maryland, probably as close as Salt Lake to Provo.

Mr. FLYNN. Absolutely.

Senator HATCH. What other factors can you provide to explain the success of Maryland's approach?

Mr. FLYNN. What other factors?

Senator HATCH. Yes; if there are any.

Mr. FLYNN. I heard the question, but I am not sure I understand what you mean.

Senator HATCH. You are citing that as an example of where divorcement and low prices actually coexist together but acknowledging that although Maryland has no refiners there are refinery systems very close—within 40 or 50 miles—are there any other factors that you can provide to support the success that Maryland has had?

Mr. FLYNN. I think that what happens is that at the retail level if you have divorcement to a great extent you can free up the retailers and jobbers to buy competitively.

In order to sell in that market, refiners have to drop their prices.

What you do is force competition backward on refining. To me, that is perhaps why Maryland has had at least a track record of being slightly below the national average, even though there is higher capital investment now by Maryland retailers.

Senator HATCH. As I understand it, Maryland does not have the wholesale pricing provision.

Mr. FLYNN. That is correct.

Senator HATCH. So the jobbers really can compete in Maryland.

Mr. FLYNN. Yes.

Again, we are talking about——

Senator HATCH. That may not be the best illustration though.

Mr. FLYNN. Again, when you get into the wholesale transfer of price business and rack pricing, to me that is a totally different question.

What a branded dealer would face as a problem after divorcement would still be the problem of having to take his supply through a particular channel of supply. He is not free to buy outside of it.

What the bill would do under open supply is give him that freedom, so long as he does not misbrand the product. On open supply, generally, he perhaps would see competition drive the price down to where it is at least comparable for all dealers.

The transfer price requirement of the bill is to try to prevent price discrimination.

Bob has referred to the great Robinson-Patman Act as the savior of the dealers. Anybody who knows anything about Robinson-Patman right now knows that: One, it is absolutely nonusable in most gasoline cases because of the commerce standard.

You have to have two or more completed sales "in commerce."

After cases like *Belliston* in Utah, and elsewhere, no one with half a brain now brings a Robinson-Patman Act case in a retail gasoline situation unless you have a very clearcut commerce situation.

The damage proof of Robinson-Patman has recently been undermined by the Supreme Court.

Quite frankly, I use some nasty language, I guess, in my statement. I tend to overstate things, as you know, Senator.

Senator HATCH. Professors are like that.

Mr. FLYNN. Campbell and I argue all the time.

Senator HATCH. Both of you qualify as professors.

Mr. FLYNN. Bob and I argue all the time.

RECOURSE TO ANTITRUST LAWS

On his argument that you have recourse to the antitrust laws, when you look at that from a dealer perspective, I claim that that is wholly unrealistic. Most dealers do not have the resources to even contemplate a lawsuit.

I personally have told them that.

Second, in most of the situations we are talking about, the law does not apply—at least it is going to be very difficult to make it apply.

By the time a case is litigated, you are going to see perhaps all the dealers in this room out of business—not necessarily as a result of practices of the oil companies but because they will have retired or died. It just is not a practical remedy. That is why you do not see cases brought.

Senator HATCH. I think Mr. Campbell makes a pretty good point though with regard to smaller refiners.

Mr. FLYNN. The point being that they will take——

I doubt that very much.

Unless they have supply in the form of crude readily accessible to their refineries, they are as vulnerable to the power of the majors as dealers are. That is part of the problem in Salt Lake.

I would disagree with Bob that we do not have a market concentration problem in Salt Lake. I think we have a very severe one.

Even though there are six refineries which is highly unusual, only two of those refineries are large enough to serve the market efficiently.

Second, those two are the ones that control the crude pipeline into Salt Lake, so the other companies exist at their sufferance.

Mr. CAMPBELL. Mr. Chairman?

Senator HATCH. I will make this my last question so that Senator Metzenbaum, the author of the bill, can have a crack at Mr. Campbell.

Go ahead, Mr. Campbell.

Mr. CAMPBELL. I was going to say that if there is a dominance in the Salt Lake market, or for that matter any other market, it ought to be brought to the attention of the antitrust enforcement people.

I do not necessarily mean a Clayton 4 civil remedy. I am talking about action by the attorney general. I am talking about action by State attorneys general.

The principal thing we want to eliminate is the disease of predatory pricing which, in fact, may be is going on.

Senator HATCH. I presume that has been done if there is a dominance.

Mr. CAMPBELL. It has been done in numerous instances. The case books and the national reporter system are full of cases in which there has been predatory pricing found in various industries, including the petroleum industry.

Section 2 remedies have been taken, including divestiture, if a court finds that it is required under those particular circumstances.

Senator HATCH. I would imagine it would be interesting to have you, John, and Mr. Baxter get together for a debate.

Mr. FLYNN. I would enjoy that, Senator—very much so.

Senator HATCH. Senator Metzenbaum?

Senator METZENBAUM. Mr. Campbell, I found your testimony interesting. I think you are a reasonable person.

I want to ask you this. In response to Senator Hatch's question which was, have those who have been victimized found reasonable recourse in the courts, you said yes. Could you tell me how?

Mr. CAMPBELL. How, Senator?

Senator METZENBAUM. Yes. How did they find reasonable recourse in the courts? Has any court awarded a dealer a judgment? Has any court come down with a judgment in favor of the antitrust department? How have they found reasonable recourse?

SUCCESSFUL ANTITRUST ENFORCEMENT OF LARGE COMPANIES

Mr. CAMPBELL. I can give you specific circumstances of which I am personally aware in Utah in which both Texaco and Conoco were required to pay damages to retail dealers several years ago in antitrust litigation for not only predatory pricing but for other exclusionary activity.

There have been from time to time cases, yes.

Senator METZENBAUM. If a dealer came to you now with a case and the facts were pretty good or very good, would you be willing to take the case on a contingent fee basis? If not, how much would he have to come up with up front in order to obtain your services?

Mr. CAMPBELL. He would have to pay the costs of litigation, apart from professional fees.

Yes, I would be willing to. I would go to the mat for him if I found there was predatory pricing in a market. I would do whatever I could to help him. I think I would have an obligation to do that as a member of the bar.

Senator METZENBAUM. You would be willing to take it on a contingent basis?

Mr. CAMPBELL. On a contingency fee basis; yes, Senator.

If we do recover, there are court-awarded attorney fees that could be as much as 15 percent.

Senator METZENBAUM. I have a hunch that by the time you get back to Utah, you may have a line waiting. [Laughter.]

Mr. CAMPBELL. I am not soliciting any business. I was just answering a question.

Mr. FLYNN. You will get it, because you are one of the few lawyers I know who would do it on that basis.

He would get a lot of business on that basis.

Mr. **Campbell**. I think most lawyers who are as interested in the enforcement of the antitrust laws as I, and indeed I am, and John knows that—I would be willing to do so, and I hope every member of the bar is.

The time when we cannot represent small businessmen with their problems—small only in the sense that they have dollars but very big to them—is a sad day. It is an indictment not only of the antitrust laws but of our profession as well.

Senator **Metzenbaum**. In view of that representation on your part, and I totally respect what you have said and do not challenge your statement at all, how do you account for the fact that there have not been more suits filed, in spite of the fact that so many dealers have been put out of business and have been forced up against the wall and testified today in connection with what has occurred to them, in my own State as well as in almost every State of the Union?

Mr. **Campbell**. I think that a good deal of it is a result simply of the interaction of competition in the marketplace.

Competition is not always equitable and a superficially fair policy. It is difficult sometimes Sometimes it is a result of harsh, strong competition that one does not succeed in business. Some people are forced out—not because of predatory pricing but because they simply are not able to compete.

In many of the instances of small retailers, you have small entry barriers at the retailing level basically. That is to say, it does not take the sort of capital to get in to run one retail station as it does to operate a refining company or to operate any other segment of the petroleum industry in the economy.

There is a lot of transiency and change of business operations from time to time among small retailers.

Those who are bona fide in the retail business—and I have a couple of them who are clients—have been in the business and have gone through the sixties and the gasoline war prices of the sixties and the seventies and the OPEC embargo and the very substantial increases in gasoline prices. They are still doing business today. They put out a good product; they are open 7 days a week, and they are still able to compete. I have talked to them about it.

Senator **Metzenbaum**. Mr. Campbell, you are a reasonable man. You are obviously intelligent.

You know, as I know, because I have been in stations when the dealer has said to me: the station across the street is selling gasoline at a lower price than I can buy it. The station across the street is owned by the company that supplies me with my gasoline.

If there were no problem and if there were not these predatory pricing practices—if it were not for the fact that Mobil said to people who were selling gasohol, you cannot do that and we are going to pull your franchise, and we had to come through with a piece of legislation to prohibit them from doing that, which we did get through the Congress—if it were not for those situations, you would not have this many people coming forward and begging for this legislation.

In Indiana, refiner-owned is up 353 percent; lessee-dealers are down 37 percent.

In Ohio, refiner-owned is up 198 percent; lessee-dealers are down 49 percent.

Throughout the country, you see figures of this kind.

There is a problem. For you to say that you believe in normal competitive factors operating is great, but it is contrary to what is the reality of the situation.

When they up the rents, when they hold back the cash, when they give them a more difficult time on credit cards, and when they require them to pay immediately on delivery instead of 1 week or 2 weeks as had been the case, all of these are just the economic screws twisting, meanwhile leaving the dealer out there twisting and turning in the wind to the point where he is eliminated from the marketplace.

As intelligent as you are, to say we should let normal economic practices prevail when they are not prevailing and to say let them have their recourse in the State antitrust laws or the Federal antitrust laws when that becomes a very unrealistic solution to the dealer, I think it is unrealistic of you to be testifying to that effect. I have difficulty in comprehending it, because you are smart.

Mr. Campbell. Do you wish me to respond to that? [Laughter.] I did not know if it was a question or a statement.

Senator Metzenbaum. Since I made a speech, you ought to have equal time.

Mr. Campbell. I think that my written testimony responds to that in part, Senator Metzenbaum.

I do appreciate your deep concern for the public interest that is at large in this bill.

I understand the problem that faces the small retailer in this industry.

However, I happen to believe that the larger picture of competition is what is at issue in this bill.

If a man, whether a citizen of this country or a corporation or the very small one-man gas and go operator, if he can sell at a lower price in good faith competition across the street, under the first circumstance you were talking about, and beat the price of his competitor next door, and the competitor cannot even buy gasoline for the price he is selling it at much less obtain a reasonable return upon his capital and upon his services, I think that is a concomitant of competition.

Senator Metzenbaum. It is what?

Mr. Campbell. I think that is a corollary of competition.

Senator Metzenbaum. You think that is free competition?

Mr. Campbell. Yes; and I support it.

Senator Grassley. May I interrupt here, because I was going to ask the same question as Senator Metzenbaum.

Remember what he said to begin with. The same person was supplying to a dealer filling station across the street for more money than he was selling for through his company-operated station.

Mr. Campbell. Yes, Senator.

Senator Grassley. That is what is difficult for me to justify.

Mr. Campbell. If you can tell me that the reason why he has sold to the independent retailer across the street is to see to it that on the short term or the long term that man is forced out of the market and can no longer compete, then the antitrust laws have been violated.

Getting to your second point, Senator Metzenbaum, where the rents are raised and this arm twisting. I think that is very close to predatory exclusionary conduct. It ought to be the basis for a complaint in a court of law. I think we ought to take care of that problem on a case by case basis, rather than legislating on a national industry basis, regardless of the fact that one or more companies may be engaged in the best and the highest level of competition all of us would like to see.

Senator METZENBAUM. I have to say to you that when one coffee company comes into a market and low-balls their price to drive out another one, that is predatory pricing. You would condemn that.

When Exxon or Sohio or Texaco or Mobil or whatever comes into a market and sells to the public for a lower price than they are selling to the dealer across the street,that is predatory pricing.

You are sitting here stating that there is adequate recourse in the courts. The Justice Department has already said it is not going to move into it. Congressman Bedell quoted them to that effect.

You know full well that there are not many dealers in this country who can afford to go through the courts for 2, 3, or 4 years.

FTC VERSUS EXXON LITIGATION

The case of *FTC* v. *Exxon* is how old now?

Mr. CAMPBELL. It was brought, I think, in 1972 or 1973, I believe.

Mr. FLYNN. It was 1974.

Mr. CAMPBELL. It is about 6 or 7 years old.

Senator METZENBAUM. It took them 5 years just with respect to the question of subpenas.

Now, thank the Lord, isn't it wonderful, they have decided to drop the case.

Isn't that great?

And you think that some little dealer is going to be able to handle an antitrust case against a major oil company which has unlimited financial resources, when the U.S. Government had to drop its case because they said they could not move the case forward.

You come before us and tell us: I think you have adequate recourse in the courts. How can you say that and be as intelligent as you are? [Applause.]

I will go back to my questions; I am sorry.

You have figures which purport to show that the eight largest integrated refiners share of the market has declined over the last 10 years. Do those figures show to which firms they lost that market share?

Mr. CAMPBELL. I do not have those, Senator, that would show to which firms. It is clear that the top eight I saw, and I obtained this information from independent sources while I was at Oxford, indicated that the market shares were picked up by other refining companies and other retail interests—both small, in the sense of a one- or two-owner retail operation, as well as maybe larger companies that have a chain of retail stations.

Senator METZENBAUM. Do you know what percentage they lost in the next eight largest integrated companies?

Mr. CAMPBELL. After the first eight?

Senator METZENBAUM. Yes.

Mr. CAMPBELL. The first eight lost about 6 percent market shares. I do not know what the second eight did.

Senator METZENBAUM. I meant what percentage of the market share which the first eight lost was lost to the next eight——

Mr. CAMPBELL. I do not know that. I do not have those figures.

Senator METZENBAUM. If you could get them, we would appreciate your making them available to us.

Mr. CAMPBELL. I will see what I can do; yes.

Senator METZENBAUM. Thank you.

Mr. CAMPBELL. Do you mean for the same time periods we are talking about?

Senator METZENBAUM. Yes.

Would you care to comment on the fact that the ninth largest oil company in the country, Conoco, indicated that they feel that a national share of the market is truly not the important factor but it is a percentage share of the regional market that is truly the critical factor.

Mr. CAMPBELL. I think I have already commented on that in my direct testimony. I will be happy to do so again.

I do think that there is an argument. John made the argument this morning, Senator, that the market that is the most relevant in the antitrust sense is the local geographic market.

I think in many instances, that is the case as well.

I do not know what——

Are you referring to the argument that Conoco made in the Mobil complaint recently filed?

Senator METZENBAUM. Yes.

Mr. CAMPBELL. It could well be that is the case.

What you are really involved with is horizontal or vertical competition in certain specific markets. Those markets can be national, but they can very often also be local.

As I have said, the genius of the antitrust laws is to isolate those markets on a case-by-case basis. If we find predatory pricing ongoing, we ought to take care of it on a local basis.

If I could address the question as to how I could feel this way about the industry and about the adequacy of remedy that each retailer has:

My judgment is that if we are going to live by the rule of law and permit the free market to operate, rather than have the Congress carve up and decide who is going to do business in a given market at a given time, we have to let that free market go.

If that free market is operating with good faith competition on the merits and if there is economy of scale achieved through vertical integration—and there may or may not be—but if there is, that also should be recognized and permitted.

Ultimately, the general public and the consumer will achieve or realize through vertical integration, lower costs of the seller and lower prices at the gasoline pump.

ANTICOMPETITIVE EXCLUSIONARY CONDUCT

As I have said before, if there is the sort of exclusionary conduct that you have indicated—namely, the arbitrary raising of rents in a certain market—and if it is shown that it does not happen just with retailer A but is also happening with retailer B, C, D, and E in that same geographic market, I think you have a very substantial case of predatory pricing or exclusionary activity.

An antitrust suit should be brought—not just for monetary damages or treble damages but for injunctive relief to stop that.

If we find that, after preventing that sort of conduct, we cannot do anything about it, then we ought to move to the point of requiring divestiture. I support that position.

I would just say on a case-by-case basis.

Senator METZENBAUM. It is obvious that you and I disagree on the question of whether or not there has been predatory pricing. I think that the people who are here to testify as independent dealers are prepared to address themselves to specifics far better than I can.

Mr. CAMPBELL. Possibly they are.

Senator METZENBAUM. I will let them do that.

Let me ask you a question.

Let us assume that we let this procedure continue on to the point that we eliminate all the independent dealers. Now we have only left in the marketplace the vertically integrated oil companies.

You are suggesting that then free competitive forces would work.

If that be the case, how do you account for the fact that when Exxon announces it is going up 2 cents a gallon, across the country all the majors go up 2 cents a gallon almost within 24 hours in every single instance. When they go down 2 cents a gallon, the same thing occurs.

There is not truly any real competition in the marketplace between the majors. Won't it be worse if there is total vertical integration?

Mr. CAMPBELL. That is a hypothetical question. I do not believe that that is going to happen.

If there is, however, to assume your hypothetical, a point reached in which there is nobody left except the 16 people that would be carved out of the market if S. 326 were enacted into law and then this 2 cent price was going on, on the one hand that may be a reflection of simply oligopoly pricing that occurs in almost any industry.

We have the steel industry doing the same thing. We have also the same thing happening in the appliance industry or the car industry. Somebody will indicate an increase in their prices, and somebody else will go to meet it. The banking industry does the same thing. Somebody raises the prime rate and somebody else goes to meet it as a matter of competition.

I do happen to believe that in the gasoline market, we are still talking about local retail markets as a relevant criteria for antitrust policy.

If we find, however, that the large majors are combining, either directly or indirectly, to simply raise prices to the consumer at the retail level, then I think we have big problems. The whole industry would then have problems in the antitrust sense. Those problems ought to be dealt with by an effective enforcement of the U.S. antitrust laws.

Senator METZENBAUM. I just commented on the fact that the U.S. Government gave up. They said the oil companies were too tough. They could not afford to keep fighting the oil companies.

They have already said it, and you are here saying that that is what should be done.

This administration sure is not going to be any tougher than the previous administrations. Obviously, they are going to be a lot weaker; because they are turning their backs on all antitrust enforcement.

The new head of the FTC is saying that we do not even want to enforce the antitrust laws.

What do the poor American people do? Who is speaking up for them? Isn't this a chance for the Congress to take some action that at least would be a step in the right direction?

Mr. CAMPBELL. No, Senator. I think that this is not the right time to axiomatically carve up this industry, regardless of who has competed well and who has not competed well.

That is the big problem that I see with this.

If this committee could legislatively say: Aha; Exxon you have done something in the Cincinnati market. As a result of that, you ought to be divorced from competing as a businessman in the Cincinnati market in the retail business. I would support that.

That would be a finding on a case-by-case definition of a very anticompetitive practice.

Senator METZENBAUM. This is not the first time this bill has been before us.

Mr. CAMPBELL. I know it isn't.

Senator METZENBAUM. If you will go back and look at the record, you will find a lot of places where you can say: Aha.

Mr. CAMPBELL. And they ought to be taken care of it seems to me.

Senator METZENBAUM. Who is going to take care of them?

Mr. CAMPBELL. On a local basis.

Senator METZENBAUM. What local basis? Do you want them to be picketed?

Mr. CAMPBELL. No.

Senator METZENBAUM. What do you want to happen? What should happen on a local basis?

That is like this administration telling the States to go ahead and solve all their problems.

Mr. CAMPBELL. I think I have answered that, Senator, by——

Senator METZENBAUM. State antitrust laws?

Mr. CAMPBELL. That is one.

The Antitrust Division, of course, operates in all the States to remedy all violations of the Federal antitrust laws.

It is not just the present administration that has taken a position, as I understand it, with respect to divorcement in the petroleum industry but the past administration.

As I recall, John Shenefield had some testimony to give at one time that they opposed divorcement on an industrywide basis. That was under a different administration.

As far as the Exxon complaint before the FTC is concerned, there are a lot of factors that entered into it. Some of those were simply the political change of the winds, I suppose, and not antitrust enforcement under section 5 of the Federal Trade Commission Act as deceptive or unfair business practices.

Senator **Metzenbaum**. One of the first things that Griffin Bell did when he became Attorney General was to come before this committee—the entire Judiciary Committee—and indicate that he supported divorcement with respect to the retail marketing.

Then he forgot about it.

When you say that somebody else took a position or did not——

Mr. **Campbell**. No.

What I am saying is that with respect to divorcement in the petroleum industry, it has not depended on which party has occupied the Justice Department at 10th and Constitution.

There has been a rather consistent position on the part of antitrust prosecutors. We assume that they are doing the best possible job they can in the public interest and they oppose divorcement on a wholesale, arbitrary basis, such as is set forth in S. 326.

Senator **Metzenbaum**. We won't debate that further.

Senator **Grassley** [acting chairman]. Mr. Campbell, in your testimony, you indicate that from 1970 to 1978, the market share of major refineries most often declined rather than rose. Therefore, you use that as a reason why divorcement was not a proper solution to the independent dealer's problem.

In 1979, a field hearing on this subject was held in my State of Iowa where the Department of Energy figures were presented that indicated that in 1972 approximately 12.5 percent of all gasoline sold at retail level in this country was sold through refiner-marketer gas stations.

The current figures in 1979 show that almost 26 percent of gasoline sold was pumped through the major refiner-operated outlets.

Would you please comment on these figures and reconcile this evidence of an increase in major refiner market shares with your contention that major refiner penetration is not taking place?

Mr. **Campbell**. Was that in the State of Iowa?

Senator **Grassley**. Those figures are nationwide, but the figures were presented at a field hearing in the State of Iowa.

Mr. **Campbell**. I see.

I would suspect that if those figures are accurate—and I do not know where they come from and what the source of them is, and I do not know anything about them—but assuming that they are accurate, it would reflect that the major oil companies are becoming more active in the retail level and are selling a large proportion of the supply of gas.

When you are talking about 26 percent of an entire market, that still has not reached the proportions that, at least under the best antitrust dialog, would suggest that there is a monopoly at play or that there is a conspiracy to force out a business—retail or independent retail businessmen.

Or, for that matter, that there is any exclusionary conduct going on—exclusionary conduct in the sense of being anticompetitive conduct like raising rents arbitrarily and unfairly that do not reflect market price.

Senator GRASSLEY. I will not comment on your statement, but you do not have any figures that would indicate or any feeling that these——

You do not see this as a bad trend then—going from 12.5 to 26 percent?

Mr. CAMPBELL. I see it as a competitive trend. I think it is one that you have to examine on a case-by-case basis.

Those were national figures weren't they?

Senator GRASSLEY. Yes.

Mr. CAMPBELL. If I take then the position of John here, sitting with me at the table, the national figures are irrelevant. It is the local market and the geographic areas that really count.

Mr. FLYNN. I did not say they were irrelevant, Senator.

Bob's number that he is talking about in the national market: I have been looking around for a similar number. Bob's number comes from the NPN fact book. It is for 1977 or 1978; I can't recall which.

Mr. CAMPBELL. 1978.

Mr. FLYNN. Some of the numbers exclude major and growing companies. For example, his chart did not have Sohio on it. I would think that is a rather major company and one that should not be overlooked in domestic figures.

NPN has stopped producing numbers, reporting it this way. It is very difficult to find the number.

I think the crucial one is the one that you have been citing. That is the refiner-marketer share of the market. That is where most of the growth has been taking place.

My numbers do not show it quite as large as yours, but it has gone from 14.8 to 19.8 since 1975 to 1981. Branded independents have dropped from 75 to 68.7. To me, those are the crucial numbers—not some manufactured group of major companies.

Senator GRASSLEY. Before I leave, let me make an announcement for the majority.

It is our desire on this side to continue with the panels after you are done questioning this panel.

I have a meeting that started at 12 and I am not going to be able to come back.

We are going to have the staff continue receiving testimony and asking questions.

I have some questions I am going to leave for you to ask as well.

We will dismiss at 1:30, and then there is an executive session of the committee at 2. We hope that that will adjourn about 2:30, and then the hearing will continue again soon after the meeting adjourns, hopefully no later than 3. It could be earlier than that, however.

Senator METZENBAUM. I think that is fine.

Mr. FLYNN. Senator Grassley, this is the latest DOE market shares study. I can offer that for the record as well.

Senator GRASSLEY. Yes. Thank you. Without objection, that will be made a part of the record.

Senator METZENBAUM. I totally agree.

I would like to advise the leadership of the committee that I think timeliness is important with respect to this measure. I would hope that if there is to be a second hearing, that we would set it immediately after the recess, so that we can bring the matter to issue before the full committee.

I would hate to have to move to add this bill on as an amendment on the floor, but I am prepared to use that procedure if we cannot get it resolved promptly.

The session is getting rather late, and I would hope that you would be good enough to advise Senator Thurmond that I am very anxious to move forward with dispatch and bring it up for markup in the committee hearing.

I also want to say that it is my understanding that some jobbers have some problems with respect to this bill. If that be the case, I am prepared to try to negotiate a solution, because there is no desire to hurt the jobbers.

I do not want that issue to hold up passage of this legislation, as it did in the last session. We are going to move this matter and give the Members of the Senate an opportunity to vote on it before we conclude.

Thank you.

I am going to excuse myself now.

I want to say to Tracy Stanton who is from my own State that if I do not hear you, it does not mean I am not interested.

Mr. CHUMBRIS [acting chairman]. Thank you very much for your testimony.

[Material follows:]

S. 326

THE SMALL BUSINESS MOTOR FUEL MARKETER PRESERVATION ACT OF 1981

UNITED STATES SENATE, JUDICIARY COMMITTEE

Statement by

JOHN J. FLYNN

on behalf of

THE SERVICE STATION DEALERS OF AMERICA, INC.

My name is John J. Flynn and I am appearing here on behalf of the Service Station Dealers of America in support of H.R. 1362 and S. 326, bills seeking justice in the marketing of petroleum products. I have been a teacher and practitioner of Antitrust Law for twenty years. Since receiving my law degree from Georgetown University in 1961 and my S.J.D. in Antitrust Law from the University of Michigan in 1963 I have taught Antitrust, Regulated Industries and Law and Economics at the Law School of the University of Utah. In the interim I have served as Visiting Professor of Law at the Universities of Michigan, Texas, Pennsylvania, Washington University St. Louis, and Georgetown University in Washington, D. C. I have also authored the books Federalism and State Antitrust Regulation and A Collection of Statutes and Related Antitrust Materials. I have co-authored with Louis B. Schwartz of the University of Pennsylvania a widely used law school casebook, Antitrust and Regulatory Alternatives; Free Enterprise and Economic Organization (5th Ed. 1977).

From 1969 to 1971, I served as Special Counsel to the U.S. Senate's Antitrust and Monopoly Subcommittee of the Senate Judiciary Committee and as a consultant to that Committee until 1976. In addition, I have served as a consultant to the Bureau of Competition of the Federal Trade Commission and the National Commission for the Review of Antitrust Laws and Procedures. I have authored several dozen articles in the antitrust field, as well as testified before several Congressional committees, conducted classes for practicing lawyers, judges and antitrust teachers throughout the nation, and served on committees of bar associations throughout the United States concerned with antitrust issues. From 1976-1979 I was Chairman of the Antitrust Law and Economics Section of the American Association of Law Schools.

In the past twenty years I have also served of counsel in over 100 major antitrust cases. Several of those cases, as well as a substantial amount of my time with the U.S. Senate Antitrust Subcommittee, have been concerned with various aspects of the oil industry. Many of those cases and much of my activity on the Senate Antitrust Subcommittee dealt with the problems of gasoline distribution as well as other features of the petroleum industry, including the foreign operations of the multinational oil companies, vertical integration in the industry, conglomerate mergers by oil companies, the expansion of oil companies into other energy resources and technologies, and the participation of oil companies in activities like the formation and operation of the international uranium cartel.

Needless to say the views and opinions I express here today do not represent the views of any institution I am or have been associated with. They are my own views, based on twenty years of study and practice in the antitrust field and a more than passing interest in and knowledge about the structure and operation of the oil industry.

It is not my practice to testify on behalf of particular interest groups when called upon to advise legislative bodies of the considerations relevant to a particular proposal pending before the body. In fact, I have never done so before except on the issues presented here, having always testified as an objective witness beholden to no particular interest. When asked by Service Station Dealers of America, Inc. to assess their proposed bill on Retail Divorcement/anticompetitive pricing and to consider testifying on their behalf in favor of the bill before the United States Congress however, I readily agreed to do so. I did so because I have always been convinced that the public interest required that the vertical integration of oil companies into retailing and their dictatorial control of retailing be ended. It is my conviction that the only way competition can be restored to the retailing end of the industry is to free retailers to buy their supply of petroleum and other products from the best source and at the best price they can, rather than be locked into a particular supplier and be subject to that supplier's direct and indirect dictates as to price, methods of operation, hours, volume, and the other products that could be sold. I have long believed, along with many other students of the industry, that the only way we can begin to unravel the stranglehold that the interrelated and vertically integrated oil companies have gained over a basic energy supply is to begin with vertical divorcement and restore competition at the retail level. Retail competition, free of the excessive control of integrated oil companies, will generate competitive pressure on wholesale prices and begin to unravel the non-competitive structure and behavior of the industry upstream in refining, transportation and production of crude.

Recent events have only served to strengthen further my conviction that retail divorcement is in the public interest and a matter for urgent action by the United States Congress. The shortage and now relative glut of refined products, the actions of OPEC, the movement of producers and refiners into retailing, the arbitrary and often brutal termination of dealers, the gradual demise of competition at the retail level, and the very real threat of monopoly or oligopoly control of retailing, with ever higher prices and less service, inexorably point to retail divorcement. It is the urgent remedy for the crisis facing independent retailers, consumers helpless in the face of rising prices over the past 8 years, and the ominous and growing threat of an end to retail competition threatening the consuming public. Consumers are threatened with an even further demise of price competition at the retail level, greater difficulty in finding competent repair services and growing inconvenience in meeting their auto maintenance requirements. Unless something is done, the demise of independent businessmen retailing gasoline in the United States and the control of regional markets by a few major oil companies will become a reality. The consequences will be those experienced in Europe after the majors had driven out independent marketers: high prices, little service, and no competition. (See, Problems of Small Retail Petroleum Marketers, Report of the U.S. House Comm. on Small Business, Report No. 94-1762, pp. 27-32.)

My willingness to testify has only been further enhanced by knowing personally several independent branded retailers in various parts of the country, close friends of mine, who have been summarily terminated in recent years. They had served their companies and their communities with distinction for several years; they had built up fine business reputations; they had invested most of their life and their savings in their operations; they had kept up with and often led the way in new competitive strategies, and they were summarily kicked out of their stations on short notice and with little or no opportunity to salvage the efforts of a lifetime. Competition did not decide their fate; the power of their suppliers did so as shifts and changes in the petroleum industry made retailing an inviting arena for refiners to seek monopoly profits at retail in the 70's and 80's.

Thus, I needed no further incentive to testify in support of these bills. Although my statement is on behalf of the Service Station Dealers of America, Inc., the views I present have been independently arrived at, are objectively stated, and are the product of twenty years of experience in studying and dealing with the problems this bill is designed to correct.

STRUCTURE AND OPERATION OF THE INDUSTRY

It is common to blame many of our economic, social and political ills on the bloated bureaucracy of the federal government and its waste of the taxpayer dollar. A self-perpetuating monolith, detached from control by the citizen and our political processes, gains a momentum and speed of its own. Its only purpose becomes the perpetuation and greater power of the monolith, without regard to its impact upon society, the individual and the very purposes for which it was originally established. Last year's political campaign focused in large part on this current affliction of modern society and the results confirmed the widespread public concern and dissatisfaction with the failure of incumbents to deal with the affliction.

The problem is more widespread however, than just the growth and power of government. The same phenomena has occurred in the private economic sphere which is now dominated by a relatively small handful of giant corporations. Two hundred manufacturing corporations now control approximately two-thirds of the manufacturing assets of the United States. In the world economy the numbers are even more startling. It is estimated that by 1985 200 to 300 global corporations will control 80% of all productive assets in the non-Communist world. Barnett & Müller, Global Reach, p. 26 (1974). By far, the most powerful segment of these super-corporations are the major oil companies; corporations which have become vast conglomerates spreading across and dominating other energy resources like coal, uranium, natural gas production and solar technology and buying up other large businesses like Kennecott, Montgomery Ward and Anaconda Copper. Ten of the top twenty industrial corporations in the United States, ranked by assets, are oil companies whose annual gross income exceeds the Gross National Product of all but a handful of the world's largest nations.

TABLE I

(Source: Moody's Industrials (1979))

Corp.	Assets	Rank
Exxon	$47.095 billion	1
Mobil	$27.265 billion	3
Texaco	$22.791 billion	6
St. Oil (Cal.)	$17.944 billion	7
Gulf Oil	$17.114 billion	8
Atlantic Richfield	$13.712 billion	13
Shell Oil	$15.986 billion	11
Conoco	$ 9.230 billion	17
Sohio	$ 9.128 billion	18

With annual revenues in the several hundreds of billions of dollars, nearly absolute control over the supply of crude and refined products, widespread ownership of the buildings and land retailers operate from, and a long history of coercive and abusive trade practices against retailers, it is not difficult to understand why the courts, Congress and state legislatures have come to view the relationship of dealers and their suppliers as something different than an arms-length and freely arrived at contractual relationship. Indeed they view it as a form of serfdom rather than free enterprise and as a relationship that is so at odds with our traditional notions of freedom of contract and private property rights that the public interest requires legal intervention beyond just the concern with the gross disproportion in size between a $49 billion dollar worldwide corporation and the small individual entrepreneur with his life's savings sunk into a single service station in Pittsburgh, Birmingham, North Platte, Salt Lake City, Boise, Boston, Fort Wayne, or Yuma. It would be humorous, if the results were not so sad, to watch the spokesmen of the oil companies dress themselves in the mantles of free enterprise, the market, and the American way when it comes to debates about their relationship to their dealers. Government studies, like D.O.E.'s Title III Report, only add to the Kafka-like dark humor. The pontifications of government officials, manipulating economic models detached from reality and statistics with no basis in fact, are little more than irrelevant theoretical exercises confirming unfounded and unexamined assumptions. They are neither sound in theory nor in fact. The industry is not one of free enterprise, the market does not decide who succeeds and who fails, and it is not the American way for one side of a so-called contractual relation to have all the power and the other side none. Judge Wisdom, one of the most widely respected judges in the United States put it this way:

> "The relationship of a major oil company to its service station dealer goes beyond the bigness-littleness

> antithesis that exists in innumerable contract negotiations and in the operations of a modern large business. The inherent leverage a major oil company has over its dealers results from the market structure of the industry and the special dependence on the company of the service station dealer (who is usually also a lessee). The classic market factors of price, quality, attractiveness, and whatever enables a retailer to resell goods at a profit are pre-empted by the TBA [tires, batteries and accessories] distribution system superimposed from on high by *dues ex machina*. A man operating a gas station is bound to be over-awed by the great corporation that is his supplier, his banker, and his landlord. When he hears that Shell will benefit from his patronage of sponsored TBA outlets, the velvet glove of request has within it the mailed fist of command. His interest in catering to Shell's sponsorship of certain TBA will be especially strong when the time for lease renewal approaches (once a year) or when a change in rental or commission appears in sight. The run of the mill service station dealer is a man of limited means who has, for him, a sizable investment in his station. Much of the value of that investment is in goodwill attached to the gasoline he sells, the TBA he stocks, and the location of the station where he sells these products. While it is true that it is expensive for Shell to switch dealers, it is far more expensive, in relative terms, for a dealer to lose his station."

Shell Oil Co. v. F.T.C., 360 F.2d 470, 487 (5th Cir. 1966), cert. denied, 385 U.S. 1002 (1966).

In other industries, where similar imbalances of bargaining power and/or complete dependence for supplies have upset our traditional bias toward market solutions and freedom of contract, we have not hesitated to prevent abuse of competitors and injury to the public interest by divorcing one level of the market from another. We have done so, for example, by prohibiting powerful meat packers from entering into retailing, motion picture producers from operating theatres, and commercial banks from engaging in investment banking and vice-versa. Elsewhere the Public Utility Holding Company Act has restricted financial pyramiding of utility ownership and cross-ownership between gas and electric utilities; auto manufacturers have been prohibited from terminating, threatening or coercing auto dealers by special statute; oil company franchisors have been restricted from arbitrarily terminating franchisees by the Petroleum Marketing Practices Act; and many states have found it necessary to enact special franchise statutes to prevent abuse of franchisees by franchisors. We have done so because experience and common sense have demonstrated over and over again, that such circumstances result in one side exploiting the other, in the competitive process being destroyed, and the public interest being sacrificed. We intervene to restore freedom of contract, freedom of enterprise, and the competitive process.

What is proposed by these bills is not, therefore, unique or unusual. Indeed, it is the common legal response to circumstances which are found today in the oil industry. What is unique and unusual is that it has taken this long for the only sensible remedy to be seriously considered, because the oil industry is truly unique as an industry in which vertical integration and horizontal interlocks have so completely displaced the competitive process as the rule of trade. To fully understand the implications of what is being said here, some technical concepts must first be explained.

You will hear the terms vertical and horizontal integration invoked throughout the course of considering this proposal. Quite simply these terms relate to the idea that the production, manufacture and distribution of goods take place in separate or distinct steps from the raw material stage to the ultimate purchase or consumption of finished goods by the consumer. For example, a farmer may grow cotton, which is then processed by a firm into bales for sale to a cotton mill. The cotton mill converts the bale into thread and then a fabric which in turn is sold to a shirt manufacturer. The shirt manufacturer dyes, cuts up and manufactures a shirt which is sold to a wholesaler. The wholesaler sells the shirt to a retailer like K-Mart, Nordstroms, Sears, or a small retailer in your home town. The retailers sells the shirt to the consumer. Each step of the process is a separate production, manufacturing, or distribution step. When one step is integrated with another that is called vertical integration. When the activity at one step, say shirt manufacturing is integrated with the same activity of shirt-making by another firm or individual, that is called horizontal integration.

In the context of bringing gasoline or diesel fuel from beneath the earth to the tank in your car, truck or tractor, the process has been broken into four or five independent steps. It looks like the following:

CHART I

Crude oil
production

Crude oil Transportation
(Pipeline, tanker, etc.)

Refining

Wholesale distribution
(Pipeline, truck, jobbers, etc.)

Retail Distribution
(Gas stations, truck stops, etc.)

Consumer

When a single company, as do each of the major oil companies and many of the minor companies, operates at each step of the way, it is called a vertically integrated oil company. When a Company operates at two or more steps of the process it is called a partially integrated oil company.

Horizontal integration in the oil industry takes place when two or more companies operating at the same functional level of the market join forces. Thus, if two refiners merge, the economist or antitrust lawyer calls that horizontal integration. Likewise, when two competitors at the same functional level of the market get together and form a joint venture to engage in a distinct step of the process of producing oil and delivering it to your gas tank in the form of gasoline, they have undertaken horizontal integration of that activity -- direct elimination of competition between them in performing that particular activity. In the oil industry, horizontal integration takes place when two supposedly independent oil companies form a joint venture to build a pipeline or refinery, or get together through a joint venture to bid upon and produce oil from a tract of land, an area of the country or a concession from a foreign country. A form of horizontal integration, by contract, can also take place through something the industry calls exchange agreements in the industry. Exchange agreements are long term arrangements by which one company (say Texaco), agrees to supply another company (say Amoco) crude oil at Amoco's Salt Lake Refinery in exchange for gasoline for local distribution by Texaco. Somewhere else in this world, usually, Texaco will do the same thing with its refinery for Amoco. Or two companies may simply agree to supply each other's local needs for finished products on a gallon for gallon or some other basis; Company A agreeing to supply all of Company B's needs for gasoline in Salt Lake in exchange for Company B doing the same from its refinery in Denver. Competition is eliminated by such arrangements since each company foregoes its competitive advantage to serve the common interest of each.

It is important for you to understand these concepts in order to appreciate the urgent need for this legislation and to understand the misleading rhetoric and half truths usually thrown up like a fog bank by opponents when this kind of bill is under legislative consideration. In addition to claims that multi-billion dollar oil companies are small entrepreneurs like you and me and the entrepreneur selling lemonade on the street corner, you will probably hear that the industry at each level is highly competitive, fragmented, and the personification of the American way. You will be told that no one company controls an overwhelming share of crude oil production, refining or retailing. As a general proposition, with the important exception of local markets dominated by pipeline, refining or crude production in a few hands, this general proposition is true. So what is the problem, you might ask, if we have thousands of producers, twenty or thirty pipelines, a couple of hundred refiners, thousands of jobbers and tens of thousands of retail outlets?

The problem is that this rosy picture is completely at odds with reality; realities like the domination and control of local markets by a single or small number of producers and refiners. It is at odds with the reality of O.P.E.C., the tightening control over refining by the major oil companies, the reality of the high degree of vertical integration in the industry; and, the reality of the host of horizontal interrelationships at every level of the industry. These realities are so significant and pervasive that they have led one of this nation's leading economists, Dr. Walter Adams, to state flatly: "The claim . . . that the petroleum industry fits the structural model of effective competition is pure fiction." Adams, Vertical Divestiture of the Petroleum Majors: An Affirmative Case, 30 Vand. L. Rev. 1115, 1121 (1977). I would put it a bit more strongly: Those who are lulled into believing that the oil industry is competitive in accord with the model of competition probably also believe in the tooth fairy, unicorns and the sandman.

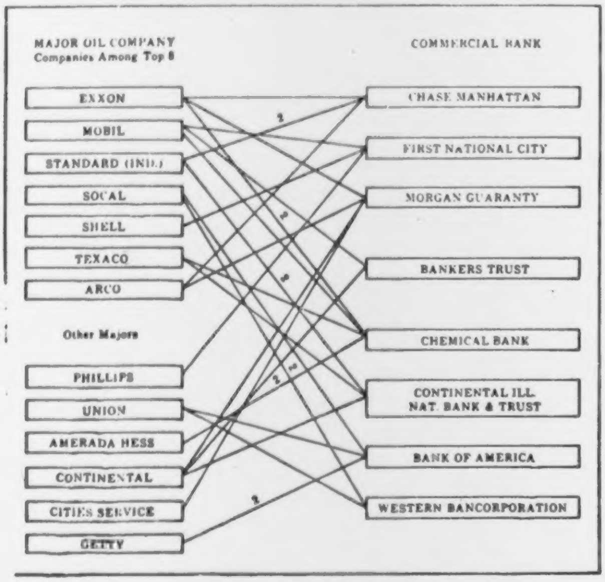
The reasons for Dr. Adams' conclusion I will only briefly outline here by way of background information and to place in perspective the rather extravagant claims made about the competitive nature of the oil industry. Comprehensive studies of the question may be found in J. Blair, The Control of Oil (1976); Allvine & Patterson, Competition, Ltd./The Marketing of Gasoline (1972); Ruttenberg, The American Oil Industry: A Failure of Anti-trust Policy (1973); Sampson, The Seven Sisters (1975) and many other books and articles of recent note. In addition, several studies by U.S. Senate and House Committees document fully the reality that big firm cooperation has displaced competition; that uncontrolled economic power has gained control from crude to the nozzle of our most basic resource; and, that a belief that competition is a characteristic of the industry in many local markets is pure fantasy.

The following outline of the horizontal interlocks and entanglements at each level of the industry is merely the barest outline of the degree to which the competitive process has been displaced in the marketing of petroleum products.

Interlocking Directorates Through Banks

Commonality of bank directors on oil company boards is one source of building up a community of interest rather than a high

INDIRECT INTERLOCKING DIRECTORATES AMONG MAJOR OIL COMPANIES THROUGH COMMERCIAL BANKS (1972)

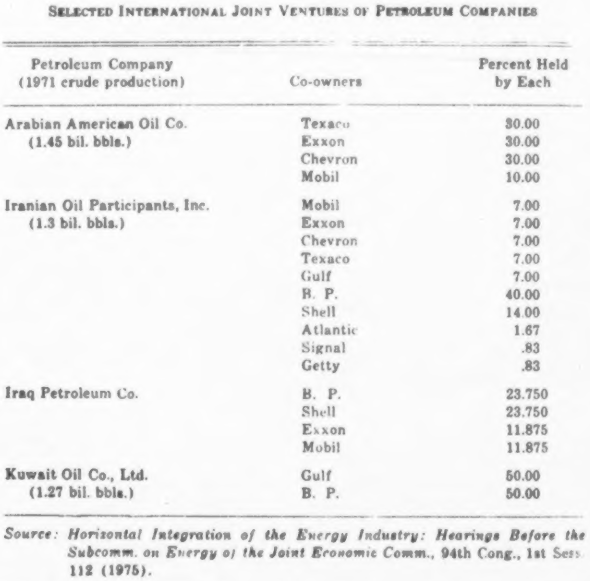

MAJOR OIL COMPANY
Companies Among Top 8
COMMERCIAL BANK
EXXON
MOBIL
STANDARD (IND.)
SOCAL
SHELL
TEXACO
ARCO
Other Majors
PHILLIPS
UNION
AMERADA HESS
CONTINENTAL
CITIES SERVICE
GETTY
CHASE MANHATTAN
FIRST NATIONAL CITY
MORGAN GUARANTY
BANKERS TRUST
CHEMICAL BANK
CONTINENTAL ILL. NAT. BANK & TRUST
BANK OF AMERICA
WESTERN BANCORPORATION
2
2
2
2
2
2

level of competition between oil companies. The following diagram from Blair, The Control of Oil 145 (1976) is but one attempt to trace and demonstrate the identity of interest at the fundamental level of shareholder ownership and management control.

Other studies reveal commonality of stock interest in several major oil companies by banks and legatees of the old Standard Oil trust -- the Rockefeller interests. Such numbers are hard to come by, since the secrecy of who owns what is maintained by every device possible.

Selected International Joint Ventures of Petroleum Companies

In most of the major producing areas of the world, prior to nationalization in some of them, oil production was in the hands of joint ventures formed by our supposedly competitive major oil companies. Today they serve as handmaidens of OPEC; they have become the marketing arm of the producing countries' cartel which has raised crude prices to astronomical levels.



SELECTED INTERNATIONAL JOINT VENTURES OF PETROLEUM COMPANIES

Petroleum Company (1971 crude production)	Co-owners	Percent Held by Each
Arabian American Oil Co.	Texaco	30.00
(1.45 bil. bbls.)	Exxon	30.00
	Chevron	30.00
	Mobil	10.00
Iranian Oil Participants, Inc.	Mobil	7.00
(1.3 bil. bbls.)	Exxon	7.00
	Chevron	7.00
	Texaco	7.00
	Gulf	7.00
	B. P.	40.00
	Shell	14.00
	Atlantic	1.67
	Signal	.83
	Getty	.83
Iraq Petroleum Co.	B. P.	23.750
	Shell	23.750
	Exxon	11.875
	Mobil	11.875
Kuwait Oil Co., Ltd.	Gulf	50.00
(1.27 bil. bbls.)	B. P.	50.00

Source: Horizontal Integration of the Energy Industry: Hearings Before the Subcomm. on Energy of the Joint Economic Comm., 94th Cong., 1st Sess. 112 (1975).

OPEC cannot work without the cooperation of these international joint ventures and vice-versa. The major reason for the astronomical rise in oil company profits in recent years has been the mutual cooperation of OPEC and big oil in limiting production and raising prices.

Joint Ventures Among Allegedly Competing Oil Companies

International joint ventures undermining the competitive process are complemented by joint ventures in domestic production. For example, on page 18 is a tabulation of the number of joint bids for federal offshore leases for a two year period. It represents a series of floating joint ventures, where one of our supposedly vigorous independent competitors joins forces with first one and then another oil company to bid on potential lease sites. During the period, for example, Getty made no independent and 281 joint bids with a wide combination of other oil companies; Phillips no independent and 281 joint bids; Union no independent and 245 joint bids.

Adam Smith's observation: "People of the same trade seldom meet together, even for merriment and diversion, but that the conversation ends in a conspiracy against the public or in some contrivance to raise prices" (The Wealth of Nations 117 (Everyman Ed. 1919)), should at least give concern to those professing to see no significance in these numbers.

Concern should turn to alarm, for those familiar with the tactics used by the Standard Oil trust to monopolize the industry in the 1890's by gaining control of transportation, when one considers joint ventures controlling pipelines. Opposite is a listing of joint ventures in some of the major oil pipelines.

In case someone tells you that the joint control of pipelines is not a problem because most of them are common carriers subject to ICC regulation, you might wonder about the vigor of regulation in light of the following chart showing an annual return that would make any monopolist envious.

JOINT BIDDING IN FEDERAL OFFSHORE LEASE SALES (1970-72)

Company	Number of independent bids	Bidding partners	Number of joint bids with each
Amerada-Hess	0	Signal	50
		Louisiana Land	51
		Marathon	51
		Texas Eastern	16
Amoco	6	Texas Eastern	117
		Union	96
		CNG	79
		Transco	15
		Shell	14
Atlantic-Richfield	13	Cities	106
		Getty	73
		Continental	114
Chevron	79	Mobil	25
		Murphy	17
		General American	17
		Pennzoil	12
		Pelto	13
		Superior	9
		Gulf	7
		Burmah	4
		Mesa	4
Cities Service	7	Atlantic	106
		Getty	100
		Continental	163
		Tenneco	3
Continental	27	Atlantic	114
		Cities	163
		Getty	102
		Tenneco	5
Exxon	80		
Getty	0	Atlantic	73
		Cities	100
		Continental	102
		Placid	4
		Superior	2
Gulf	17	Mobil	17
		Pennzoil	8
		Standard Oil of California (Chevron)	7
Marathon	24	Signal	65
		Louisiana Land	69
		Amerada	51
		Texas Eastern	29
Mobil	8	Pennzoil	30
		Standard Oil of California (Chevron)	25
		Mesa	16
		Burmah	13
		Gulf	17
		Ashland	2
Phillips	0	Skelly (Getty)	69
		Allied Chemicals	66
		American Petrofina	34
Shell	59	Transco	47
		CNG	15
		Standard Oil of Indiana (Amoco)	14
		Florida Gas	17
Sun	115	Pennzoil	2
Texaco	15	Tenneco	32
Union	0	Amoco	96
		Texas Eastern	96
		Texas Gas	48
		Florida Gas	5

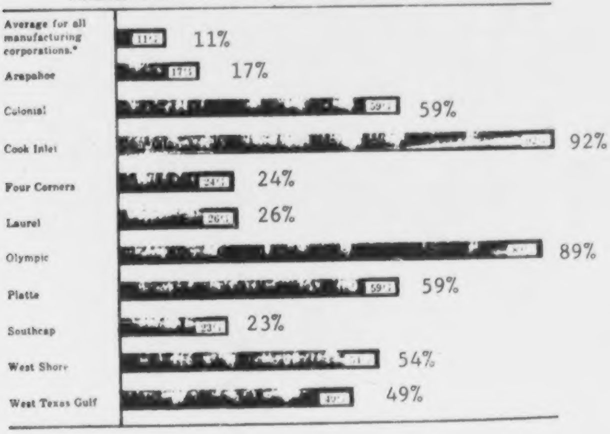
Source: The Natural Gas Industry: Hearings Before the Senate Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, Part 1, 93d Cong., 1st Sess. 481 (1973).

Joint Ventures in the Oil Pipeline Industry

Pipeline company and co-owners	Percent held by each	Pipeline company and co-owners	Percent held by each
		Texaco	17
Badger Pipeline Co.		Clark	11
(assets = $12,400,000):		Marathon	10
Atlantic-Richfield	34	Cities Service	8
Cities Service	32	Shell	7
Texaco	22	Platte Pipeline Co.	
Union Oil	12	(assets = $33,000,000):	
Dixie Pipeline Co.		Continental	20
(assets = $46,400,000):		Marathon	25
Amoco	12.1	Union Oil	15
Atlantic-Richfield	7.4	Atlantic-Richfield	25
Cities Service	5.0	Gulf	15
Continental	4.1	West Shore Pipeline Co.	
Exxon	11.1	(assets = $17,600,000):	
Mobil	5.0	Shell	20
Phillips	14.5	Amoco	16.5
Shell	5.5	Mobil	14
Texaco	6.0	Texaco	9
Gulf	18.2	Marathon	9
Transco	3.6	Clark	8
Allied Chemical	6.0	Cities Service	8
Laurel Pipeline Co.		Continental	6.5
(assets = $35,900,000):		Union Oil	5.6
Gulf	49.1		
Texaco	33.9	Exxon	3.5
Sohio	17.0	Wyco Pipeline Co.	
Colonial Pipeline Co.		(assets = $14,100,000):	
(assets = $480,200,000):		Amoco	40
Amoco	14.3	Texaco	40
Atlantic-Richfield	1.6	Mobil	20
Cities Service	14.0	Yellowstone Pipeline Co.	
Continental	7.5	(assets = $16,000,000):	
Phillips	7.1	Continental	40
Texaco	14.3	Exxon	40
Gulf	16.8	Husky	6
Sohio	9.0	Union Oil	14
Mobil	11.5	West Texas Gulf Pipeline Co.	
Union Oil	4.0	(assets = $19,800,000):	
Plantation Pipeline Co.		Gulf	57.7
(assets = $176,100,000):		Cities Service	11.4
Exxon	48.8	Sun	12.6
Shell	24.0	Union Oil	9.0
Refiners Oil Corp	27.2	Sohio	9.2
Four Corners Pipeline Co.		Chicap Pipeline Co.	
(assets = $20,900,000):		(assets = $25,600,000):	
Shell	25	Union Oil	43.4
Chevron	25	Clark	33.2
Gulf	20	Amoco	23.4
Continental	10	Cook Inlet Pipeline Co.:	
Atlantic-Richfield	10	Atlantic-Richfield	20
Superior	10	Marathon	30
Olympic Pipeline Co.		Union Oil	30
(assets = $30,700,000):		Mobil	20
Shell	43.5	Texas-New Mexico Pipeline Co.	
Mobil	29.5	(assets = $30,500,000):	
Texaco	27.0	Texaco	45
Wolverine Pipeline Co.		Atlantic-Richfield	35
(assets = $21,800,000):		Cities Service	10
Union Oil	26	Getty	10
Mobil	21		

Source: The Natural Gas Industry: Hearings Before the Senate Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, Part 1, 93d Cong., 1st Sess. 485 (1973).

PIPELINES: AVERAGE ANNUAL RETURN ON PAID-IN INVESTMENT, 1968-72



*FTC, QUARTERLY FINANCIAL REPORT FOR MANUFACTURING CORPORATIONS (1968-72).

Source: ICC, TRANSPORT STATISTICS IN THE UNITED STATES, PIPELINES, PART 6, (1968-72).

Pipeline joint ventures, whether they are crude pipelines or pipelines carrying finished product from refineries to distribution points, are crucial control points. A producer without access to a pipeline or other means for transporting crude to a refinery, has a worthless well -- unless he can sell out to someone with access to transportation. A refiner without crude or ownership rights in a pipeline is dependent on pipeline owners for his supply of raw materials. Without a steady and predictable supply of crude, the refinery is simply a worthless pile of plumbing. A refiner dependent upon its competitors to move refined product out of the refinery by a product pipeline, operates at the whim, discretion and mercy of its competitors since you simply cannot use a refinery for anything else or store the ever-flowing flood of a volatile and bulky product. These implications of joint venture pipeline ownership have been described by Beverly Moore as follows:

> "Almost every one of the major pipeline systems constructed since World War II is jointly owned by the few companies which dominate the marketing areas which the pipelines serve. From the standpoint of the owners, the arrangement is perfectly natural.

> If a few companies wish to exploit a market by constructing a joint venture pipeline to it, they will have little interest in inviting all their actual and potential competitors to come along with them. Likewise, the owners will have an incentive to lay the line so that it or its feeder spurs will pass in close proximity to their own refineries and marketing terminals, but not to those of their nonowner competitors. The owners will have an incentive to provide input and output facilities, storage tanks, and synchronization geared to their own operations, but again not to those of their nonowner competitors.
>
> The result is that, while joint venture pipelines are theoretically common carriers, equally accessible to all, access can be substantially more expensive for nonowners than for owners.
>
> This initial disadvantage is widened by the fact that the nonowner must pay the full rate or tariff while the owner actually pays only the pipeline cost, recouping the difference through the pipeline company's dividend payments to him. The rate-cost differential which measures this further degree of discrimination is commonly as high as 20 to 30 percent."

(Source: Anticompetitive Impact of Oil Company Ownership of Petroleum Products Pipelines: Hearings Before the House Subcomm. on Special Small Business Problems of the House Select Comm. on Small Business, 92d Cong., 2d Sess. 129 (1972)).

The integrated majors can also use their monopoly or joint pipeline control to limit or control the flow of crude or product to independent refiners or distributors through a number of subtle and difficult to control tactics. According to the Federal Trade Commission's 1973 Investigation of the Petroleum Industry, these tactics include: "[(1)] requiring shipments of a minimum size, (2) granting independents irregular shipping dates, (3) limiting available storage at the pipeline terminal, (4) imposing unreasonable product standards upon independent customers of the pipelines, and (5) employing other harassing or delaying tactics." Id. at 26.

Thus, in markets with allegedly independent refiners, one should not be seduced into believing those refiners are truly independent. Refiners dependent upon crude and product pipelines for their input or output, just as refiners dependent upon their competitors for crude, are not and cannot be truly independent competitors. They are more like wards of their transportation and supply system; a transportation and supply system in the hands of competitors who will not tolerate independent pricing, supply, or marketing tactics. Thus, if you are told that the United States is blessed with many independent refiners, take a look at who supplies their crude, who controls how the crude gets to the refinery and who controls the pipeline taking out refined product. As an example, I have prepared a chart showing you how the so-called independent refiners in Salt Lake are not truly independent. (Appendix A) As you will see from our chart, the situation in Utah is like that elsewhere in the United States. Small independent refiners are dependent on their competitors, in most cases, for crude and for pipeline transportation. They are about as independent as Macy's would be of Gimbel's if Macy's depended on Gimbel's for its stock of goods to sell and Gimbel's trucks to deliver them to Macy's store.

I have no chart, nor has anyone ever tried to construct one, of the aforementioned exchange agreements at the refinery level. These are agreements to exchange crude for refined product or refined product for refined product. In Utah, for example, Amoco supplies its supposed competitor Texaco with the gasoline sold through Texaco stations. Conoco supplies Mobil; we haven't been able to track down Chevron's supply to its so-called vigorous competitors. Rumor has it that Chevron is withdrawing from branded retailing in Utah, just as other majors have withdrawn from other sections of the United

States. Exchange agreements must be at an agreed upon price; and when one major company exchanges supply with another at the wholesale level, price competition is eliminated. Independent retailers cannot play the game, since they are precluded from buying gasoline at the refinery and must buy it through and at the price set by their branded franchisor. Ever since F.T.C. v. Sinclair Refining Co., 261 U.S. 463 (1923) branded gasoline retailers have been prohibited from selling gasoline from sources other than the holder of the brand they are licensed to use. More often than not, their supplier did not obtain the gasoline from its own refinery and oil wells but obtained it from an exchange agreement or a buy/sell arrangement with the refiner dominating a particular regional market. Thus, even though companies like Gulf, Texaco, Mobil, Shell and Union have no refining capacity in Salt Lake, they have sold gas at wholesale to their retailers in Utah at the wholesale price their exchange agreements with other suppliers establish. If that is competition, we need to rewrite the dictionary.

Exchange agreements are so widespread and so numerous, that I doubt even the oil companies know how many there are, which way they run, and who is refining or pumping gas for whom. The popular perception is that when you drive into a gas station to buy gasoline, at a Texaco station for example, that Texaco's gasoline is derived from oil discovered and produced by the Texaco man "you can trust who wears the star". Many believe another Texaco man who "wears the star you trust" carried it from the well to a refinery where other Texaco men wearing "a star you can trust" refined it and carefully put in additives Texaco told you in the 60's made your car operate better and get added mileage. Then some more Texaco men carried the gas to a happy Texaco retailer, also "wearing a star you can trust", and operating a modern station with clean as a whistle restrooms.

Its all a big fiction. In Salt Lake City, the gasoline you buy at a Texaco station comes from Amoco's refinery. Mobil's comes from Conoco through a product pipeline. It is one big happy wholesale family. Only God knows who discovered and produced the oil it was made from. No one pushes the claim that additives make much of a difference since all additives are pretty much the same anyway and the majors all operate offbrands like Amoco's Rainbo stations. Since the early 70's, the majors have begun copying the independent's innovation of competing on price rather than claims of phony quality differences or non-existent differences in additives. Our happily married and closely interdependent refiners run company-operated strings of stations while supplying their supposed competitors with product to distribute to their captured branded retailers. In Utah for example, Phillips operates wholly-owned company stations under the Bonanza name; Western operates Double Kwik; Amoco operates Rainbo and Caribou runs Maverick. Perhaps they are embarrassed to let the public know who owns and operates these stations or they are afraid the public will come to know gasoline is gasoline and the consumer should buy it at the best price and with the service the consumer desires. As for your happy Texaco, Gulf, Shell, or Amoco retailer, not many are left anymore since a lot have been kicked out of their stations and those who are left still struggle along on low margins or at a loss and under the ever present threat of summary termination by economic strangulation.

Our picture of the supposedly vigorous competitors in the oil industry would not be complete and your understanding of the current events of the industry pointing toward even greater control and integration would not be comprehensive without noting government interference with competition at the behest of the industry to further their interest in displacing the competitive process. It is widely known as welfare for the rich. Government favors have included special tax treatment in the form of the depletion allowance; the foreign tax credit and the deductibility of intangible drilling expenses; exclusion of competition and oversupply by getting the government to restrict foreign imports in the 50's and 60's and limit domestic production under the aegis of the Interstate

Oil Compact since the 30's; and a domestic energy policy designed to bring the price of domestically produced energy to the level of the rigged OPEC price per B.T.U. while neutralizing every attempt to interject competition and other government action to break the stranglehold of OPEC and its major oil company handmaidens over the pricing, production and marketing of oil products. This latter effort created a vast and complex bureaucracy. Among other things, it put a price lid on old oil, encouraged the price for new oil to rise to the fixed OPEC price for crude, set up a complex "entitlements program" requiring some refiners to pay cash to others, and regulated the price, profit and supply of retailers. The whole system is tumbling down with decontrol and about the only thing that is certain, is that the integrated oil companies will not be and have not been seriously injured thereby. The clearest victims will be retailers and independent refiners, since no longer do they have even the assurance of a source of supply regardless of price.

DEPARTMENT OF ENERGY REPORT

Pursuant to Title III of the Petroleum Marketing Practices Act, the Department of Energy has issued a series of reports purporting to study objectively the "State of Competition in Gasoline Marketing". The Final Report was issued in January of 1981. While I have only had the Final Report a short time, my preliminary study of the Report, its assumptions and its methodology suggests it is as flawed as the Department's preliminary reports on petroleum marketing. The Report's basic fault is that it seeks to measure the reality of what is going on in the market by abstract models premised upon the unreal assumptions of a world of perfect competition. Such a world does not exist; and, as my prior testimony indicates, it is the purest fantasy to assume it ever did exist in the petroleum industry. Moreover, the Report seeks to explain the reality of the industry by using abstract models to examine only one end of the industry, divorced from the other parts upstream. By a process reminiscent of the old practice of phrenology, the Report purports to examine one end of the beast with the twin assumptions that the rest of it is irrelevant and that by examining models of one part of the industry, the models can tell us all we need to know. The Report examines the light and not what it is intended to illuminate, a curious practice of too much of what is passed off as modern empirical economic research.

An analysis of the faults in the preliminary report of DOE was made by J. W. Wilson and Associates for the Service Station Dealers of America, and provided a persuasive case that the preliminary report proved the opposite of DOE's conclusion that refiner-operated stations were profitable. Some of DOE's calculations were obviously deficient. Its original netback study, for example, only took account of variable costs, not fixed costs like depreciation, for refinery operated outlets and ignored joint costs, like management costs in overseeing refinery-operated retail stations, while trying to determine whether subsidization was happening. When these other costs were included in the Wilson study, the refinery-operated stations were shown to be operating at a loss. For the record, I have attached a copy of the Wilson analysis of DOE's preliminary Report to my statement. (Appendix B).

The Final Report of DOE I can only deal with summarily here; it is a bulky and theoretically complex Report -- primarily notable for its bulk, its analysis of abstract models rather than reality, and a wholly biased and slanted approach to the task it addresses. The Report purports to isolate several cities for study of the issue of whether subsidization of refinery operated stations is taking place. Subsidization takes place where low prices are supported by high prices elsewhere; either upstream profits or profits from other markets. Subsidization is of concern because it can be an illegal use of market power from one market or level of a market to fix prices or exclude competitors from another market or level of a market. Aside from the previously mentioned exclusion of fixed and joint costs from the study and other irrational or arbitrary accounting calculations dictated by the artificial models relied upon by the study, the analysis of the subsidization issue is probably a straw man in many of today's markets where refinery-run retail outlets are growing. Prior to the OPEC embargo and shortage problem, spot subsidization was the primary problem for retailers in most areas of the country. Post embargo, with shortage and rising prices at all levels of the market, the possibility of making profits at retailing has accelerated vertical integration by firms with local refining capacity or product pipeline control. The consequences are obvious: the demise of tens of thousands of retailers cut off from supply or squeezed by high rents or high wholesale prices, and generalized chaos in retailing, refining, and the reliability of crude supplies. Termination of dealers has not only happened by attrition, but has been forced by a variety of arbitrary and unfair means. For example, I have attached an affidavit of a former Gulf Oil employee describing Gulf's tactics in terminating several California dealers while expanding its Economy Oil brand in California. The affidavit was filed in a case pending in Los Angeles and describes coercive tactics designed to terminate several dealers locked into Gulf for their supply during the post embargo period, while Gulf was building up its chain of company-operated retail stations. I suspect it describes a not isolated instance of the methods by which branded dealers have been terminated. (See Appendix C)

A more comprehensive study of oil industry structure and behavior -- one proceeding from reality to an hypothesis rather than the vice-versa of the DOE Report -- was released last March by the Canadian Restrictive Trade Practices Commission. That study, one which explored the upstream realities of the petroleum industry and its downstream consequences with the industries own documents rather than abstract theoretical models limited to one end of the industry like the DOE study, came to diametrically opposite conclusions from the DOE studies. It flatly finds a non-competitive industry structure and recommends regulation of wholesale prices, public utility regulation of pipelines, and divestiture of refinery-controlled retail outlets. We will be happy to supply a copy of this study of reality to the Committee for your use in evaluating the DOE Report and the merits of the Bill pending before the Committee. (Excerpts of the Report's Conclusions and Recommendations attached, Appendix D).

It is a part of the reality which DOE's Final Report, with its abstract models and assumptions built upon surmises with premises of conjecture, fails to take into account. A further reality not accounted for by DOE's study is the de-control of oil. A part of the DOE study attributes many of the problems of retailers to government regulation. The remainder of the Report discounts any other explanation for the widespread decline of retailers, significant shifts in marketing practices, and a growing trend toward refinery-run outlets. A further and current reality the Report does not deal with is the present over-supply of crude and excess refining capacity in the face of declining demand. Downward price pressures are beginning to be felt, along with pressures to maintain volume. While probably a relatively temporary phenomena, it is one likely to cause further chaos in retail markets with retailers feeling growing pressure to pump more volume, while locked into wholesale prices that are at or slightly below the retail price gasoline is sold for at refinery-run outlets or prices jobber-supplied outlets can afford to maintain at retail as beneficiaries of excess refinery capacity requiring product to be dumped on the spot market. The current market situation has changed significantly from the time of the DOE study. Refineries are operating at an all time low percentage of capacity, world crude supplies are in excess of demand and likely to remain there for the short term in light of the disarray in OPEC, and prices have stabilized and even fallen in some markets as pressures build to arrest the decline in demand and increase volume. The current situation may be likely to accelerate the growth of refinery-operated stations in an effort to recoup upstream declines in profit in crude and refining by maximizing profits and volume through refinery-run retail outlets and locked in franchised dealers pumping gas at a loss.

None of these events has changed, however, the central problem of retail markets -- the control of retailing by the dominant refiner or pipeline suppliers in that market over who can market the product, the price at which it is sold, and the conditions under which it is sold. Whether the over-all problem is one of shortage or surplus makes little difference to retailers whose supply, price and conditions of sale are wholly controlled by their supplier-competitor. According to the Report of the Senate Interior Committee's Special Subcommittee on Integrated Oil Operations, National Fuels and Energy Policy Study, p. 58 (94th Cong. 2d Sess. 1976) 15 states do not have a refinery; in 17 states one company owned all the refining capacity; 5 states had 2 companies with refineries; 3 states and Puerto Rico had 3 companies with refineries; and in 11 states there were four or more companies with refineries. One of the 11 is Utah where 2 companies have the overwhelming share of refining capacity. The Report points out that "regional concentration is significantly higher than that existing at the national level." All this was ignored in DOE's study, but is crucial to an understanding of why refiners are moving into retailing and squeezing out the competition.

I cannot deal with all the assumptions and analyses of the DOE Report here, but I would like to discuss one area of DOE's hypothetical rationalizations discounting predatory or unfair tactics -- DOE's analysis of what it calls "predatory costing". DOE Report, pp. 179-188. The Report notes that in order for a firm to raise a retail competitor's costs it must have a supply relationship with the alleged victim. In areas like Salt Lake City, and many other markets, this may or may not be true, since a small number of refiners control the supply of refined product in the market. A major refiner, Amoco, has also been aggressive in terminating its branded retail dealers and building up its wholly-owned "Rainbo" self-serve stations in Salt Lake City. The other refiners in the area have been doing the same thing with their own wholly-owned retail outlets. In the past few years Amoco has terminated or failed to renew over 100 retailers while building up its wholly-owned retail chain, and now has a substantial direct interest in maintaining retail prices, as well as volume at retail. Amoco also has significant control over crude supplies to the other local refineries through its crude pipeline control, and is an important factor in controlling the wholesale price of other majors and jobbers it supplies through exchange agreements or buy and sell supply contracts. The consequences are well known in the Utah market. Amoco markets through its wholly-owned outlets at retail prices at or slightly above, by a few tenths of a cent, the wholesale price it charges branded retailers. Retailers must meet the retail price of Amoco's Rainbo stations or lose sales to the wholly-owned refinery-operated outlets. You need not have a degree in economics to know what happens -- every gallon of gas pumped at retail outlets trapped in this circumstance is pumped at a loss, because the retailer's high wholesale cost prevents him from ever making a profit while selling in competition with the refinery-operated station's retail price. The independent retailer cannot buy product elsewhere since his franchise locks him into his supplier as his sole source of supply and trademark law has been used to enforce the restriction.

Antitrust policy classifies this circumstance as a price squeeze or predatory costing which can constitute a violation of Section 2 of the Sherman Act. A recent case in the electric power industry illustrates why courts have concluded predatory costing displaces the competitive process in violation of the Sherman Act. In City of Mishawaka v. American Electric Power Co., 616 F.2d 976 (7th Cir. 1980) the Court held a monopoly supplier of electric power violated

Section 2 of the Sherman Act by keeping its wholesale power price to municipal power companies higher than its retail price to industrial customers in the municipal's service area. The obvious effect of the practice was to use the defendant's market power over supply to squeeze the municipals out of the distribution business -- a classic use of monopoly power from one level of the market to monopolize another level of the market in violation of Section 2 of the Sherman Act. The major difference between this case and what is going on in many local and regional gasoline markets where the dominant gasoline supplier is moving into retailing, is that municipal power companies can afford to undergo the massive expense and long delay in bringing an antitrust suit to rectify the situation while gasoline retailers neither have the capital to bring a lawsuit nor the time to see it to a successful conclusion. Their dependent status for all their supply and often for a place from which to do business, only further undermines any possibility of gasoline retailers spending the four or five years necessary to bring an antitrust suit like the Mishawaka case to remedy the identical kind of anticompetition practice in gasoline marketing. Otherwise, the circumstance is identical -- the vertical exercise of monopoly power to exclude competition and fix prices from one market to another by a price squeeze on existing retailers.

My study of independent retail stations in Salt Lake City in early 1981, indicated a 75,000 gallon per month station -- a moderately large station -- had approximately a $5000 per month overhead attributable to gasoline operations. Somewhere, at least 6.7 cents per gallon above the wholesale price for gasoline must be realized at the retail station to cover the costs of opening up each morning. A dealer charged a $1.25/gallon wholesale price competing with his supplier's retail operation retailing the same gas for $1.25/gallon or less has a problem.

The DOE Report does not adequately explain how an independent retailer charged a wholesale price at or slightly below the retail price of his refinery-run retail competition can profitably pump gas. The Report, based on its unrealistic and abstract models, simply asserts predatory pricing cannot happen in this fashion. Instead, the Report rhetorically asks: "Why would a refiner predatorily cost against its dealers?" (Report, p. 186). Not surprisingly, since the Report assumes the industry is competitive upstream and assumes regional markets are supplied by several independent competitors rather than dominated by a single or small group of inter-related refiners or product pipeline operators, the Report professes to find no rational reason for predatory costing. Confirming one's unrealistic hypothesis by asking rhetorical questions instead of doing empirical research may be an interesting academic exercise, but it is a poor basis from which to formulate public policy.

The practice of excluding one's retailers makes sense where there is local or regional domination or control of supply, retailing is profitable and volume can be maintained by forcing retailers dependent upon a supplier for their sole source of supply to pump gas for little or nothing. It is a unique circumstance of having one's cake, eating it, and forcing others to help make more cake for nothing. Independent retailers think of themselves as independent businessmen. When faced with having to compete with their suppliers at wholesale costs that are equal to their supplier's retail market price though, independent retailers are not independent entrepeneurs, they are serfs locked in by the upstream market power of their supplier. Many pump gasoline at a wage less than $1.00 per hour, a circumstance the Secretary of Labor might find interesting if we are serious about outlawing sweat shops.

RETAIL DIVORCEMENT

I laid out most of the above background both to make understandable why retail divorcement is an urgent necessity for the public's interest and in anticipation of the numerous half-truths which will be thrown up in an attempt to defeat this bill. One claim will be that the industry is highly competitive as it is. The economist's and antitrust lawyer's definition of competition and the conditions necessary for its existence look nothing like the current structure and operation of the oil industry worldwide, nationally or in most states. What is required for competition to work is the existence of evenly matched competitors, each with access to the capital, labor, and resources necessary to compete. It is assumed further that firms can come and go as they please, and that each is independent and free to make its own judgment as to those it will buy from, those it will sell to, and the price and conditions on which it will decide to buy and sell. True competitors are supposed to be in control of their own destiny and be free to operate their business as they see fit. They do not join their competitors in joint ventures or trade products back and forth by exchange agreements except in the most unusual of circumstances. And, they do not treat their customers the way oil companies have dealt with gasoline retailers for the past several decades in the United States, if true competition exists, since in a competitive market the customer is king. It is the object of this bill to restore a competitive market, not interfere with one in place. There is not a competitive market in the retailing of gasoline and I seriously doubt whether we have really had one for several decades. The latest indication of the non-competitive nature of retailing has been the proliferation of secondary brands operated by refiners, in most cases without any identifying link with their refinery parentage.

The number and brand names of refinery-run outlets are difficult to track down. A partial list of refiner-controlled secondary brands was submitted to a Subcommittee of the House Small Business Committee in 1979 Hearings. (Petroleum Products: Supply, Price and Marketing Problems, Pages 53-55):

MAJOR OIL COMPANIES AND THEIR SECONDARY BRANDS

The following list indicates major brands and their secondary brand operations. The right-hand column is a computer number (source unknown) with the last two numbers indicating the same supplier. Example:

Amoco	102012	Supplied by Amoco.
Omega	103012	

Amoco	102012
Bradley	107012
Indolene, Amoco	103012
Omega	105012
Rainbow	108012
Whak	106012
Whale	110012
Standard Commercial	104012
Wm. Penn, Amoco	109012
Ashland	201003
Aztec	101003
Bi-Lo	202003
Conoco	102003
Continental	115003
Douglas	103003
E-Qual	104003
Econo	105003
Fasgas	106003
Fast Gas	107003
Gas for Less	203003
Gas Works	108003
GasLess	109003
Hi-Fy	204003
Hood	205003
Kayo	110003
Laurie	206003
MFA	311003
North Star	207003
North Western	208003
Nuggets	110003
Red Head	210003
Rotary	211003
Save More	212003
SoLo	213003
Super America	214003
Tex Gas	301003
U-Save-Conoco	112003
U-Serv	[illegible]
U.S. Oil	215003
Webb	216003
Western-Conoco	114003
Atlantic-Richfield	102001
FS Super Power	311001
Merit	202001
Rebel	303001
Rich Field	103001
Rocket	104001
Saveway	203001
Southern States	304001
Texas City	305001
Marathon	103007
Bonded	113007
Cheker	110007
Consolidated	106007
Gastown	101007
Hit and Design	102007
Mile Maker	104007
Pass Point	112007
Pilot	111007
Power Pakd	105007
Speedway	107007
Super M	108007
Superthon	109007
Mobil	101008
Arkla Blue	301008
Big-Bi	105008
Hi-Val	104008
Reelo	103008
Sello Gasoline	102008
Gulf	101006
400 Oil	106006
Apco	301006
Edza Go	107006
E Z Go	108006
GoLo	103006
NSI	104006
Premier	102006
Shell	101010
Beacon	301010
Gas N Go	302010
Penny Saver	303010
Ride	104010

MAJOR OIL COMPANIES AND THEIR SECONDARY BRANDS—Continued

Sohio	208005
Boron	201005
BP	202005
Canal	301005
Cetron	203005
Keotane	112005
Low Ball	116005
OK	115005
Surfco	117005
Wm. Penn	206005
Sunoco	107013
Astro Jet	101013
Cam II	111013
Circo	109013
DX	102013
Economy, Sun	103013
Kenco	104013
Mascot	110013
Maverick	301013
Par	105013
Sunlite	106013
Travelers	108013
Texaco	101014
Gull	104014
Star and Bar	105014
Union 76	102015
Firebird	104016
Harbor Union	103015
Pure Firebird	101015
Chevron	101011
Indolene, Chevron	107011
PDQ	103011
Red Crown	104011
S.O	105011
Standard	106011
Flight	102011
Exxon	105004
Alert	101004
Enco	102004
Esso	103004
Ron 90/91/97	104004
Phillips	123009
Ace	101009
Best Gas	102009
Black Gold	104009
Black Jack	105009
Boomer	107009
Buccaneer	108009
Buy and Save	109009
Flight Fuel	112009
Gas O Rama	113009
Jackpot, Phillips	115009
Lo-Ball	117009
Miss Quik	118009
Mr. Quik	119009
Mundelein Pump	120009
Paraland	122009
Quality Gas for Less	124009
Red Cap	126009
Save Gas	127009
Savon	128009
Shamrock	131009
Silver Gull	132009
Sixty Six	133009
Spot	134009
Tideland	135009
Tops	136009
U-Save, Phillips	137009
Way Lo	138009

As you can see, refiners have been busily creating a multiplicity of secondary brands from which to operate their off brand direct retail operations. The integrated companies are interested in two things at the retail level: maximizing their profits and maximizing volume. In the fifties and sixties, when we were over-supplied with cheap crude and retailer turnover approached 1/3 annually, maximizing volume was the major concern. Those were the days of games, free drink glasses, fluttering pennants and so on.

They were also the days of dealer bankruptcy, high oil company profits, and the wasting of our basic energy resource. Profits were taken upstream, where the tax loophole advantages of doing so made it sensible to do so, as well as produce and refine as much product as possible. With the decline of upstream tax advantages, the takeover of foreign crude production by the OPEC cartel, and a closer balance in refining capacity and demand -- namely shortage -- the potential for profit at the retail level has been becoming increasingly apparent. The results are also apparent: no more giveaways at the local retailer; the overbuilding of stations has stopped and has been reversed -- in Utah alone, the number of retailers has dropped by one third since 1973 from 1587 stations to 1023 stations in 1979 despite an increase of vehicle registrations from 789,000 to 1,004,000; a growing number of retail outlets sell gas only, while consumers find full service or stations offering inspections or minor repair service more and more scarce; and prices keep going up while dealer profits or "margins" remain the same or go down.

Meanwhile the integrated majors and refiners continue to move into retailing. Why do it, you may wonder? Particularly why should Amoco, for example, supply a Rainbo station, also owned by Amoco's corporate parent, at a wholesale price which allows that Rainbo station to retail gasoline at 1¢ less a gallon than the wholesale price Amoco charges its independent branded retail station one block away? The answer is obvious, if somewhat complex. It comes down to the long term potential for profit at the retail level through high volume self-serve operators, maintaining over-all volume in the interest of the refiner and protecting the stability of wholesale prices in the interest of the refiner.

Branded retailers, unlike members of the club of vertically integrated companies and local refiners, are not free to buy and sell gasoline through their stations from whatever source gives them the best prices. Texaco can buy from Amoco's refinery and sell the product under the Texaco brand but a Texaco dealer cannot do so. In many areas of the country, things are all locked up at the refining level through the mutual interdependence of the refineries locked in by the crude supply and pipeline systems and by exchange agreements or by regional market control by a small number of refiners or pipelines. Company-operated stations get the benefit of low wholesale prices while independent retailers do not. Independent retailers are charged a dealer tank wagon price that is frequently the same as the retail price their refiner-supplier is charging at its wholly-owned retail outlets. The independent retailer cannot buy product direct from the refinery offering the best price, but must buy it through his supplier, even though that supplier is directly competing with the independent retailer out on the street. Contract and trademark law prohibit independent dealers from doing the same thing. So as a major company's front (Rainbo, for example) in the retail market drops its retail price to or below the wholesale price at which an independent branded retailer can buy the product from the same ultimate source, the retailer is helpless to do anything but meet the price or go out of business. Amoco competes against its own branded retailer by selling at retail below the wholesale price it charges its own dealer because it can maximize volume while making profit at the wholesale level and the retail level.

The supplier gets volume and is able to maintain the wholesale price, since the branded retailer can go nowhere else for his product. Other retailers pose no problem since they are locked into the same system. The independent retailer is whipsawed and must pump gas for less than the minimum wage and frequently at a loss for every gallon pumped. From the supplier's view, volume is maintained or increased; the rigid wholesale price structure is maintained since the whipsawed dealer cannot go elsewhere for gasoline; and independent retailers continue to be the serfs of the industry while refinery margins continue to go up, profits on crude escalate, and the consumer pays more for less. If you think all this benefits the consumer, you should consider Europe's experience once independent retailers were driven from the market. Prices were raised to higher than ever levels and there is little hope to restore competition to retailing in Europe.

No one seriously committed to the ideal of maintaining the competitive process, as the rule of trade, can objectively look at this market system and claim it is a competitive one. It is not a competitive market and it is imperative that the law step in to restore a competitive market in the retailing of petroleum products. Precluding integrated refiners from selling at retail or engaging in predatory pricing at wholesale will achieve these goals. Those are the objectives of this bill.

ANALYSIS OF THE BILL AND OBJECTIVES THEREOF

Senate Bill 326 is primarily a predatory pricing/divorcement bill. It prohibits refiners from operating at retail or controlling retail outlets. It requires all suppliers whose employees operate retail outlets to earn as much from the sale at retail as they earn at wholesale. It would establish the pattern which exists in most industries of suppliers marketing their products through independent retail outlets and end the unusual, anticompetitive and unfair practice of refiners selling both at wholesale and then competing with retailers buying from them at wholesale by selling through wholly-owned retail outlets. The Petroleum Marketing Practices Act, prohibiting arbitrary dealer terminations and non-renewals has simply not been adequate. Rather than being eliminated by being cut off at the knees, retailers are being strangled by their suppliers pricing practices at wholly-owned outlets. Banning such a practice, by a law requiring divorcement, is not an unusual practice as mentioned earlier; it creates no government agency or bureaucracy; it does not freeze or restrict competition at the retail level; and, it restores the regime of competition at the retail level rather than interferes with it. Nor does it impose any cost of a loss of efficiency in marketing petroleum products. Leading objective observers of the industry, as well as admissions by the major oil companies themselves, discount any efficiencies based on vertical integration of all phases of the business. Walter Adams and Maurice Adelman, internationally recognized experts in the field, have flatly stated there is no evidence to support claims that vertical integration confers any efficiency benefits whatever. (See Adams, Vertical Divestiture of the Petroleum Majors: An Affirmative Case, 30 Vand. L. Rev. 1115, 1139-44 (1977)). Indeed, major oil companies have admitted as much in testimony before the South Carolina and Wisconsin Tax Commissions in proceedings involving taxation of activity at various levels of the industry. (The testimony is summarized in Adams, supra, at pp. 1140-42). Perhaps of most significance is the experience of states where retail divorcement has been adopted. In Maryland, for example, retail prices have been either at or below the national average since divorcement was adopted by the Maryland Legislature in 1974. Divorcement in Maryland has not resulted in increased prices to consumers. Should you hear claims that this bill will cause prices to increase at the retail level, I think this Maryland experience settles the issue. What has happened is that prices have not increased and pressure has been put on wholesale prices by independent dealers free to buy at the best price so they can compete against other independent dealers in competing for the consumer's dollar. Dealers have benefited and so has the consumer since the unfair and anticompetitive system of locking independent retailers out of the wholesale market and whipsawing them with strategically placed company-owned stations to push volume has been ended. Competition sets the price in Maryland; not the manipulation of vertically integrated and horizontally interconnected refiners. Competition should drive prices down nationally to the levels where they are in states like Maryland and Connecticut, rather than raise them.

Section 2(a) S. 326 makes it unlawful for refiners other than independent and small refiners to operate service stations. Independent refiner is defined as one who obtained in 1978 more than 70% of its crude from unrelated firms, while a small refiner is defined as one whose total refining capacity does not exceed 75,000 barrels per day.

Section 2(b) curbs discrimination between purchasers at the wholesale level by requiring suppliers to maintain a daily wholesale transfer price available to all purchasers and prohibits sales at different prices except where justified by differences in the cost of manufacture, sale or delivery of the product which result from different methods or quantities in which the fuel is sold or delivered. Different prices are also permitted by Section 2(b)(2)(B) where they are reductions made in good faith to meet competing price reductions offered an independent wholesale purchaser.

This is a reasonably balanced way to deal with the market power of refiners and its potential for disrupting competition at the wholesale and retail level by arbitrarily preferring one customer over another. Jobbers will not be arbitrarily and unfairly prejudiced by this section since it permits differentials in price because of: 1) different "methods" in which motor fuel is sold and delivered; and, 2) different "quantities" in which motor fuel is sold or delivered. These are the economic justifications along with meeting competition for a differential granted jobbers who perform a significant function in the distribution process. Any other jobber discounts at this level of the market end up unfairly discriminating against others down the distribution chain, and confer no discernible functional benefits on consumers of petroleum products.

This does not mean that different prices and methods of distribution will not result downstream. The bill authorizes a fee to be charged dealers who choose to operate branded stations for use of trademarks. Some dealers may offer credit card sales for branded suppliers and should pay for the privilege -- if it is one. Jobbers will remain free to operate their own chains of stations, price the product at whatever price they choose and their operating efficiencies permit, and continue to perform profitably their function of transportation and storage for redistribution. No one can predict how the market will ultimately sort itself out once a sensibly balanced system of rack pricing is finally enacted into law. My guess is that jobbers, jobber-operated retail chains and dealer cooperatives will ultimately evolve to be the major wholesale forces in the market. They will evolve to take advantage of distributional efficiencies and to bargain with competing suppliers for the best price to enable their retailers to compete successfully in the market. Clearly, the public interest will benefit, since competitive pressure will be injected at the wholesale level.

Section 2(c) provides an important guarantee for retailers by freeing them from the arbitrary requirement that they only sell product from their franchisor despite a better price and condition of sale available from others. Dealers selling under a brand would be required to notify the public that gasoline from other sources is other than from the owner of the brand they are licensed to use, a sensible limitation upon the otherwise overly broad use of trademark law to coerce exclusive dealing for supply. For years, refiners have been free to trade product back and forth for sale under their brand names even though they were not the source of the product. Retailers were not accorded the same privilege despite the widespread recognition that gas is gas. Doubtlessly, refiners will object strenuously to this provision of S. 326. They will do so in the name of product purity and the enduring wisdom of the Lanham Act; but not in the name of what actually motivates their objection. That motivation will be to prevent competition at the wholesale level and to keep retailers and jobbers from doing what major refiners have been doing for years -- claims of product purity and the Lanham Act notwithstanding.

Among the other unfounded objections you may hear about this bill are that it constitutes a violation of several constitutional prohibitions. Nine such arguments were raised against the divorcement statute adopted by Maryland in 1974, after which this bill is patterned. All nine objections were rejected by Maryland's highest court in the case of Governor of Maryland v. Exxon Corp., 279 Md. 410, 370 A.2d 1102 (1977). Exxon, Shell, Conoco, Gulf and Ashland appealed the Maryland Court's decision to the United States Supreme Court. In Exxon Corp. v. Governor of Md., 437 U.S. 117, 98 S.Ct. 2207, 57 L.Ed. 2d 91 (1978), the Court rejected all the constitutional and other objections to the statute. The Court held the statute, similar to S. 326, did not burden or discriminate against commerce, violate due process, or conflict with any federal policy regulating competition or the oil industry. The Court held:

> "The evidence presented by the refiners may cast some doubt on the wisdom of the statute, but it is by now, absolutely clear that the Due Process clause does not empower the judiciary 'to sit as a superlegislature to weigh the wisdom of legislation . . . . Responding to evidence that producers and refiners were favoring company-operated stations in the allocation of gasoline and this would eventually decrease the competitiveness of the retail market, the State enacted a law prohibiting producers and refiners from operating their own stations. Appellants argue that this response is irrational and that it will frustrate rather than further the state's desired goal of enhancing competition. But . . . this argument rests simply on an evaluation of the economic wisdom of the statute . . . and cannot override the state's authority 'to legislate against what are found to be injurious practices in their internal commercial and business affairs. . . .' [W]e have no hesitancy in concluding that it bears a

> reasonable relation to the state's legitimate purpose in controlling the gasoline retail market. . . ."

57 L.Ed. 2d at 99.

In the analagous situation of a California law severely regulating auto manufacturer control of auto dealers in order to protect retail dealers from "abusive and oppressive acts by the manufacturers", the Supreme Court upheld state legislative authority to regulate manufacturer activity at the retail level. New Motor Bd. v. Orrin W. Fox Co., 99 S.Ct. 403 (1978). The Court made clear that states have the general authority, indeed the duty, to regulate marketing within their borders. Imagined constitutional objections to the contrary do not stand in the way of Congress adopting S. 326 to promote competition, protect the consumers of the nation, prevent the "abuse and oppression" of independent gasoline retailers, and protect the economy of this country in the marketing of petroleum products.

You may also be confronted with slogans about "free enterprise" and "let the market decide" by the opponents of this bill. As my previous remarks make clear, there is no freedom of enterprise at the retail or wholesale level today, nor is it the "market" which decides who may sell petroleum products, where they may be sold and the price at which the product may be sold. Retailers are not free to buy product at the best price they can get; suppliers selling at retail undercut retailers they supply; there is no competition at the wholesale level; and, independent retailers are totally subject to the whims of their supplier. This bill is not anti-free enterprise or against the competitive ideal; in fact, it does just the opposite. It will establish the conditions necessary for freedom of enterprise and the competitive process to work at the retail level. How free is an enterprise that must compete with its supplier? How free are retailers who can only get supply from one source? How free are refiners totally dependent on others for crude and transportation? What kind of a market is it where Amoco supplies Texaco, Conoco supplies Mobil, and the refiners operate wholly owned offbrand gas and go stations competing with dealers they supply? How free is that market when independent dealers are totally dependent upon their suppliers for their location, their rent, their supply and their future? Some may try to call this a free enterprise system; I call it economic serfdom and the very antithesis of a free enterprise system.

You may also be told that the existing antitrust laws can take care of the problem. You will be told that there are all kinds of penalties for those who violate the antitrust laws as well as treble damages for persons injured by a violation of the law. In theory, this is true; but in fact it will be one of the more cynical and false arguments made by the opponents of this bill. The expense, time, delay, hassle and risk aspects of antitrust litigation protecting a dealer in these circumstances are so overwhelming as to make the alternative of antitrust enforcement a cruel joke. If any dealer came to me and any other experienced antitrust lawyer with a clearcut violation and asked me to file suit for him I would tell him the following things:

> "I will not file suit unless you put up $10,000 to $25,000 in cash to cover the initial expenses -- expenses not including my fee -- of filing the suit and covering the in-going discovery and other steps necessary in present day antitrust litigation;
>
> The first reaction you may expect from your supplier is that you will be cut off from supply and, if you lease the station from that supplier, the second thing that will happen is that your lease and franchise will be cancelled.
>
> If we are lucky, we may get to trial in 18 months or two years, unless the defendants pull some tactics like they have in many cases, of delay, excessive motions, endless discovery, and innumerable appeals. There is a fellow

named Redd in Utah whose case has been going on since 1974 and it is still not resolved. The F.T.C. case against the major oil companies has been going on for six years without even completing the discovery, while the oil companies have asserted, litigated and appealed the ridiculous claim the F.T.C. must file an environmental impact statement before it can bring suit (they lost) and they have litigated to the U.S. Supreme Court the claim that the filing of the complaint itself is a final appealable order (they lost). I would tell the dealer also, that even if we get to trial in a year or two you can expect it will be a mud slinging contest and there is no way of predicting whether we will win or not. Appeals can go on for several more years and your costs and legal fees can easily exceed $100,000. If we do win some year in the future, I can pretty well guarantee you will not be able to stay in the business since no supplier will take you on.

Consequently if you want to go ahead, be prepared to put up every dime you have and you can borrow, be prepared to find some other work as soon as we file suit, be prepared to wait several years for a final result, mortgage everything you own and be prepared to spend well over $100,000 even if you lose."

This is not an imaginary dialogue; I have told dealers exactly this and I know many other lawyers who have done the same. I know most dealers do not and cannot afford to sue under the antitrust laws once they know the realities of what it entails. For all practical purposes, recourse to the state or federal antitrust laws for gasoline retailers injured by the tactics of their suppliers is about as meaningful as recourse to the Russian Constitution is for citizens of Russia injured by acts of the Soviet state. It looks nice on paper, but it is a cynical joke in reality to anyone confronted with the problem. People who tell you otherwise do not know what modern antitrust litigation is all about and do not understand the plight of dealers confronted with the choice.

Another objection you may hear is that divorcement will cost the consumer more in terms of price and quality of service. We have a track record for assessing these claims. Prices in Maryland, where divorcement has taken place, have not increased. If anything, they have been below the national average even though there is no significant local refining in Maryland. The experience in Connecticut is to the same effect. Refiners are forced to compete to supply retailers and I would expect that the experience would be to enhance price competition at the wholesale and retail level, rather than lessen it. This will happen because dealers will be free to buy at the best wholesale price they can get and refiners will have to cut wholesale prices if they expect to move their product.

Experience in Maryland and Connecticut also suggests that freeing up competition at the retail level confers other benefits on the consumer. One benefit is that truly independent retailers choose a variety of ways to market their product: gas only, gas and service, gas and car wash, gas and groceries and a variety of other forums. The refiner-owned outlet usually provides one kind of service just as Henry Ford provided one kind of car -- the black Model T. Most refiner-operated stations sell gas only, you pump it yourself, and you must remember to check your own tires, battery, antifreeze and so on. Retail dealers offer this kind of service as well and would continue to do so, as well as a variety of other forms of service. It will be up to the customer to choose which kind of service they prefer, rather than the coming prospect of gas-and-go refiner-operated gas-only service. I prefer dealing with a dealer who provides service, does repair work and can conveniently take care of doing an inspection or helping me with other auto problems. Like many consumers, I am finding these services are fewer and farther between. I spend more time looking for them and find my car is less well cared for. Like other consumers, I have had emergency repair problems and found only gas pumps and a bullet-proof booth occupied by a clerk when I sought help. No service, no help and not even a phone was a available. I could buy beer however, to dissolve my frustration I guess before walking to search for a full service station. We pay a price for this state of affairs; a price of frustration; wasted time searching for service; less safe automobiles; and, even more risk on the roadways.

A second consumer benefit will be an upgrading of service station equipment and ability to repair or service your car. Dealer investment in equipment in Maryland has gone up dramatically (over 60% per year) once the threat of termination and the unfair competition of refiner operated stations was removed by this kind of law. The same thing will happen nationally once dealers know the investment they make in their business will not be forfeited next week by being cut off by their supplier or by being driven into bankruptcy by a refiner operated station selling gas at retail cheaper than a dealer can get it from the same refiner at wholesale. Better dealer equipment means better consumer service in the maintenance and repair of your car. And if you are as mechanically incompetent as I am, you will need all the dealer help you can get.

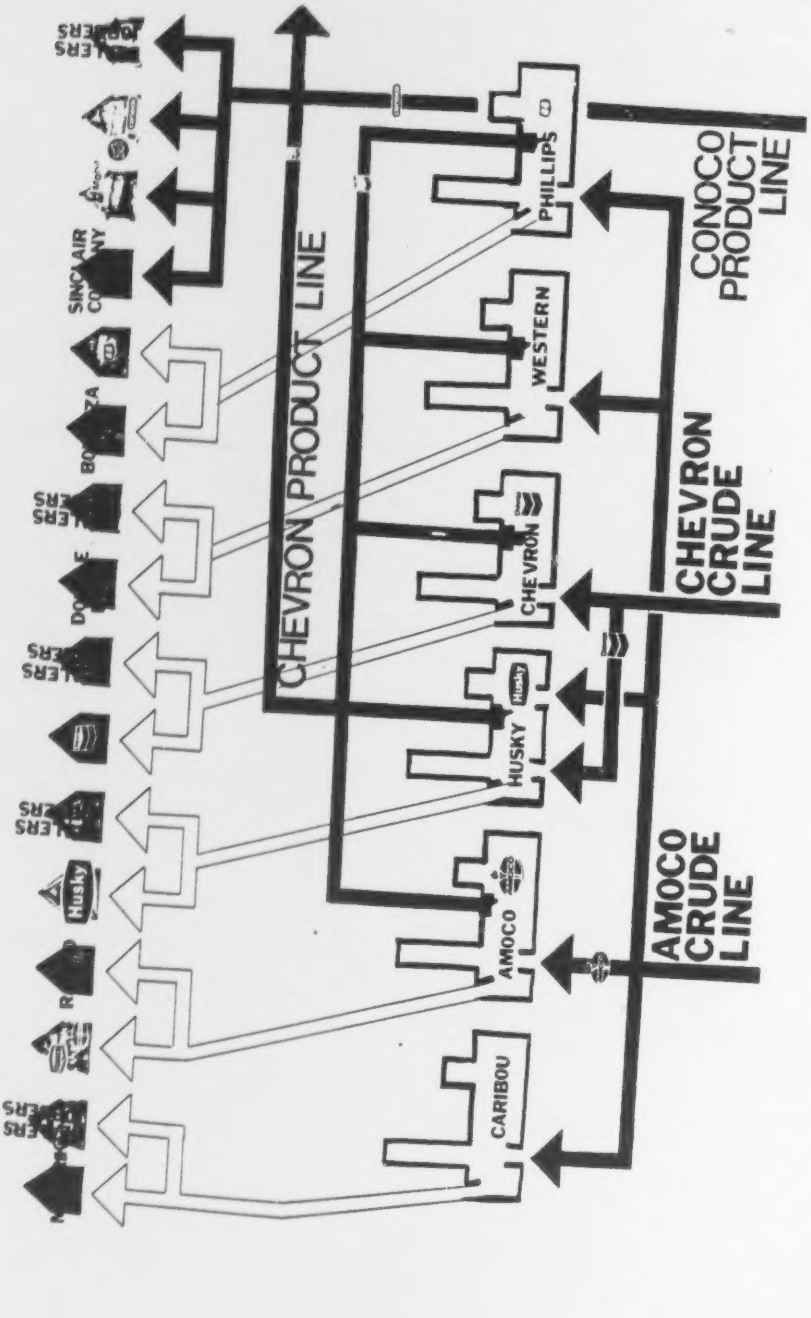
A third benefit, one realized in Connecticut almost immediately after divestiture took place, is that dealers will be free to offer new fuels now coming on the market. Oil companies have not been big promoters of gasohol. They do not yet control its source or manufacture. Dealers who sought to sell it from branded pumps soon found themselves in trouble with suppliers promoting gasoline volume. Divestiture in Connecticut saw the immediate introduction of gasohol for those consumers who wished to buy it and those sellers willing to supply it. Consumers using premium, a scarce commodity, have found gasohol a workable substitute. Others, concerned about lessening our imports of oil, buy gasohol since it stretches gas supplies by 10%. Farmers and others looking for new markets have found gasohol an inviting new market. Retail divorcement will guarantee they will have a place to sell the product and consumers wishing to buy the product will have a place to buy. Dealers, independent businessmen who were the first to promote the product, will have the freedom to bring it to the market without fear of being terminated.

The Connecticut experience with gasohol is only one example of benefits consumers may expect from divorcement. Freeing up competition at the retail level so that the imagination and enterprise of truly independent and competitive retailers can be put to work, rather than the single-minded dictates of those who control supply, will bring consumers innovation, variety, and the benefits of a truly competitive free enterprise marketplace. Independent retailers have been the source of most of the innovations in marketing, not the integrated companies. That undisputed history will continue if this bill is passed. If it is not, innovation in marketing-like price competition -- will be as dead as 30¢/gallon gasoline.

CONCLUSION

This Congress has the opportunity to bring true competition to the retailing of petroleum products. It is in the interests of your constituents to do so and justice and fairness to the long suffering retailers requires it. There are no constitutional, economic or practical objections justifying any hesitancy in passing this bill. Where similar bills have been made law by states, consumers have benefited from the law, as have the small businessmen who are the backbone of marketing in this economy. They do not seek something for nothing; they do not seek something that is not theirs. They seek the restoration of a free market in the retailing of petroleum products and the fair opportunity to compete for a share of that market as best they know how. It is the responsibility of the law and those who have the duty to define it to see to it that the citizens of this country and the independent retailers who serve them have the benefits of a competitive market. That is all we seek and this bill is the only way to guarantee that gasoline marketing will take place in a free and competitive market. I urge you adopt this bill because the public interest clearly requires you do so and the future vitality of a significant arena for small business in our country mandates this bill be adopted before competition in petroleum retailing is forever eliminated.

Appendix A.--Pipeline and refinery distribution, Salt Lake City


CHEVRON PRODUCT LINE
CONOCO PRODUCT LINE
CHEVRON CRUDE LINE
AMOCO CRUDE LINE
PHILLIPS
WESTERN
CHEVRON
HUSKY
Husky
AMOCO
CARIBOU
SINCLAIR COMPANY
JOBBERS
DEALERS

Appendix B.--Preliminary DOE title III study

Report to the

SERVICE STATION DEALERS OF AMERICA

on

PART I -- The State of Competition in Gasoline Marketing; the Effects of Refiner Operation at Retail (A Study Required by Title III of the Petroleum Marketing Practices Act)

September 1980

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EXECUTIVE SUMMARY

In response to Title III of the Petroleum Marketing Practices Act, the Office of Competition (OC) in the Department of Energy has prepared and submitted to the Congress a report entitled The State of Competition in Gasoline Marketing. This report was completed and released in May 1980, and it is identified as Part I of the analysis required by Title III of the Petroleum Marketing Practices Act.

The Service Station Dealers of America has asked J.W. Wilson & Associates, Inc. to evaluate this report by DOE's Office of Competition. This paper presents the results of that evaluation.

In summary, J.W. Wilson & Associates believes that the OC report fails to identify and analyze properly the threat to retail competition in gasoline marketing that occurs when vertically integrated petroleum refining companies engage in extensive retail marketing operations through refiner-operated gasoline and service stations. In general, the OC report fails to find evidence that the integrated refiners have engaged in practices to build up their own refiner-operated retail gasoline operations at the expense of independently operated service stations, including those of dealers who sell the major refinery brands. This paper demonstrates that the OC conclusions are marred by faulty analytical procedures, and that a proper interpretation of the OC data support a conclusion exactly opposite to that reached by OC.

A major part of the OC study is a detailed analysis of gasoline retailing operations in the Fort Wayne, Indiana market. A proper analysis of the OC data for Fort Wayne, as presented in this study, demonstrates that

-- Vertically integrated refineries experienced losses during 1978 at refiner-operated high volume retail gasoline outlets in Fort Wayne.

-- The average price of gasoline sold at refiner-operated gas only outlets was at least 4.2 cents per gallon below the price required for the refiners to have earned a normal rate of return on their investments in these retail gasoline stations.

-- The average price paid to refiners by lessee and open dealers in Fort Wayne was more than 3 cents per gallon higher than the "transfer price" charged by refiners to their own company-operated retail gasoline outlets.

These facts indicate that predatory pricing, subsidization of refiner-operated retail gasoline outlets, and a price squeeze may have been occuring in Fort Wayne during 1978. The OC Title III Report, in contrast, used a faulty methodology that failed to identify all of the costs incurred by integrated refiners in their retail operations, and thus failed to find any indications that these anticompetitive practices might be occuring.

The second focus of the OC Title III Report was on national data concerning activity by vertically integrated refiners in the direct ownership and operation of retail gasoline outlets during the 1970's. Using the OC data, this study demonstrates that the refiner-operated segment of the retail gasoline market has been the most rapidly growing segment during the last decade, and that for at least some integrated refiners, the increases in retail sales through refiner-operated outlets appear to have been made possible largely through decreases in sales by these same refiners to their dealers. Moreover, these disparate trends constitute a major shift in marketing channels, and they have been accompanied by a very large decrease in the number of independent service stations. The OC Report uses the same underlying data, but it fails to make the analyses presented in this study, and instead seeks to rationalize the obvious trends in retail gasoline marketing as relating to factors other than the state of competition in this industry.

I. INTRODUCTION

In May of this year, the Department of Energy's Office of Competition (OC) submitted to the Congress Part I of its analysis of the extent to which integrated petroleum refiners may be subsidizing their retail motor gasoline operations. This analysis was required by Title III of the Petroleum Marketing Practices Act.

The authors of the Title III study describe the basic thrust of their report as an examination of three issues:

(1) Are integrated refiners subsidizing their company operated gasoline retail outlets?

(2) Are integrated refiners moving gasoline away from their branded dealer network into their own retail outlets?

(3) Are integrated refiners manipulating the allocation system in favor of their own retail outlets to the detriment of other gasoline marketers?

The major preliminary conclusions contained in the Title III study are:

(1) There is no evidence of predatory subsidization by refiners in the Fort Wayne, Indiana retail motor gasoline market; and

(2) No massive movement by integrated refiners towards the direct ownership and operation of retail gasoline outlets has taken place during the 1970's;

(3) Allegations that integrated refiners have diverted large volumes of product away from their branded dealers and into their own company stores are not supported by nationwide sales data;

(4) Allocation regulations at the federal level may have contributed significantly to the problems experienced by independent branded dealers during the 1970's.

The purpose of this Report is to provide the Service Station Dealers of America with J.W. Wilson & Associates, Inc.'s assessment of the analytical approach and the validity of the preliminary findings and conclusions contained in the OC study.

In summary, we believe that the DOE study is flawed throughout and that there is virtually no empirical foundation upon which its authors' findings and conclusions can be supported.

Specifically, we believe that:

(1) The "netback" analysis used to determine whether predation and subsidization of retail operations by refiners in the Fort Wayne, Indiana market have taken place is not an appropriate test for this form of anticompetitive conduct.

(2) If all relevant costs are included in the analysis, it appears that, on average, refiners' high volume

retail outlets in Fort Wayne experienced losses during 1978. This finding indicates that predation and subsidization of retail operations by refiners may have taken place in that market.

(3) Operating statistics presented in the Title III report indicate that in 1978, the average price of gasoline sold at refiner-operated gas only outlets would have to have been 4.2¢ per gallon higher for refiners to have earned a reasonable rate of return on their investments in those stations.

(4) For a number of integrated refiners, increases in retail sales through company stores appear to have been made possible through decreases in those same refiners' sales to dealers since 1972. This is inconsistent with OC's conclusion that refiners have not diverted large quantities of gasoline away from dealers and into their company stores during the 1970's.

(5) There should be genuine cause for concern over the rapid expansion into direct ownership and operation of retail gasoline outlets by some, but not all integrated refiners.

(6) Predation and subsidization by integrated refiners of their retail operations need not be present for substantial competitive problems to exist in the gasoline marketing industry. This is because integrated refiners control the supply and the cost of gasoline sold to their rivals. Thus, lessee dealers, jobbers and unbranded marketers can be squeezed out of the market if their product costs are artificially

inflated, relative to the transfer price paid by refiner-operated outlets for comparable services. This form of potentially anticompetitive conduct was not addressed in the Title III study.

Our Report is organized in four parts. Part II is a brief digression on the economics of predatory pricing, subsidization, and the application of these concepts to retail operations in the motor gasoline industry. This section of our Report is not intended to represent the final treatise on the theoretical principles associated with predatory pricing as a form of anticompetitive conduct. Rather, it is presented as a useful and necessary framework around which the quality of the Title III report can be assessed. Therefore, the economic principles discussed in Part II are directly related to the analytical approach adopted by the authors of the DOE report.*/

Part III contains our anlysis of the approach taken and the findings and conclusions arrived at by the authors of the Title III report. In this section of our Report, we pay particular attention to OC's use of "netback" analysis for purposes of examining whether integrated refiners have subsidized their retail gasoline operations in Fort Wayne, Indiana. We also present alternative measures of profitability at refiners' company stores in Part III.

Lastly, Part IV contains our concluding comments.

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*/ We believe that this discussion is both useful and necessary because virtually no theoretical or practical justifications for the analytical approach adopted by its authors are presented in the Title III report.

II. THE ECONOMICS OF PREDATORY PRICING, SUBSIDIZATION AND THE APPLICATION OF THESE CONCEPTS TO RETAIL GASOLINE OPERATIONS

As industrial firms in the U.S. economy have grown in size and expanded their operations across many markets, economists have recognized that the pricing and output decisions of large, multiproduct enterprises may often differ from those of geographically dispersed, single-product firms. Of particular concern is the potential for vertically integrated firms and large corporate conglomerates to engage in sustained price cutting in specific markets so as to undermine the viability of their much smaller rivals. This type of anticompetitive market behavior involves both predation and subsidization, which are described by Professor F.M. Scherer as follows:

> Although there is some disagreement among scholars over semantics, predatory pricing is said to occur when a seller cuts price below the level of its rivals' costs for protracted periods, until the rivals either close down operations altogether or sell out on favorable terms. The predator's motivation is presumably to secure a monopoly position once rivals have been driven from the arena, enjoying long-run profits higher than they would be if the rivals were permitted to survive. . . . In other words, it subsidizes its predatory operations with profits from other markets until the predation creates conditions that will repay the original subsidy. */

For predation and subsidization to exist in the foregoing sense, two conditions must be met.

(1) The alleged predator's financial resources and staying power must be substantially greater than those of smaller rival firms in the same market; and

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*/ F.M. Scherer, Industrial Market Structure and Economic Performance, 2nd ed. (Chicago: Rand McNally, 1980), pp. 335-336.

(2) The potential for prospective net revenues exceeding current net revenues foregone must be sufficiently large to justify the predatory pricing policies of the dominant firm(s) in the market.*/

While establishing that the first of these conditions is present is seldom a problem in cases involving alleged predatory practices, a showing that the second condition has also been met is exceedingly more difficult. This is because predators are simply not about to publicly announce the ultimate objective of their pricing campaign and thereby knowingly subject themselves to prosecution and conviction under the antitrust laws. Therefore, most investigations of alleged predatory pricing have focused upon direct evidence (i.e., testimony of corporate officials and decision-making documents, such as executive memoranda, marketing strategy reports, etc.), when available, and indirect evidence concerning price/cost relationships in the relevant market.

In this connection, it must be recognized that the establishment of prices at levels below a competing firm's costs does not necessarily mean that the price-cutter is engaging in predatory pricing. This is so because unit costs are seldom uniform for all firms within a given market or industry. Indeed, it is precisely because costs vary between firms that exit, entry and fluctuations in relative market shares, all in response to changing market conditions, are commonplace within the U.S. economy. Therefore, most investigations of alleged predatory pricing have focused more upon the price/cost relationship of the alleged predator, as opposed to a comparison of its prices with the costs of smaller competitors in the same market.

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*/ Arieda, Phillip and Turner, Donald F., "Predatory Pricing and Related Practices Under Section 2 of The Sherman Act", in Harvard Law Review, (February 1975) p. 698.

If the relationship between a firm's costs and its prices is to be used as a test of predatory intent, then it is essential that the proper identification and measurement of "costs" be made. For example, should the alleged predator's prices be compared against its:

(1) Marginal costs, which are solely a function of changes in variable costs per unit of output;

(2) Average variable costs, which include only those costs which vary with output (i.e., labor, maintenance, utilities, fuel, raw materials, etc.); or

(3) Average total costs, which include the sum of variable and fixed costs (i.e., all variable costs plus management overhead, depreciation, interest expense, property taxes and a normal return (profit) on the firm's investment)?

Clearly, when prices are set at or above average unit costs, no case can be made that a price-cutter is engaging in predatory pricing. This is because unit revenues are sufficient to recover all costs and provide investors with the required return on their investment in that enterprise. This simply represents a situation in which market prices may be profitable to one firm but unprofitable to one or more of its rivals. On the other hand, if the alleged predator's prices fail to cover its average variable costs, then obviously that firm is earning no return at all and it would incur fewer losses by simply ceasing operations altogether.

Of critical importance to the selection and measurement of appropriate costs is the relationship of time to the industry in question. This is because it is seldom the case that business costs fall neatly into the "fixed" and "variable" categories of economic theory. For example, most capital goods are readily detachable from a particular corporate enterprise for sale on the open market; thus the cost of their services is essentially variable even if they were originally financed through the issuance of long-term debt securities.*/ This is particularly true in certain industries, such as airlines, trucking, railroads, fast food retailing and gasoline marketing, where the major components of capital costs (i.e., aircraft, trucks, rail cars, restaurant facilities and gasoline station property) are frequently and routinely sold or leased among firms in those industries. Thus, over a period of time as long as six months to a year, it is reasonable to expect that prices established by efficient firms in these industries will equal or approximate their average total costs. On the other hand, over significantly shorter periods of time, prices may fall below costs in nearly all industries when market conditions temporarily reflect uncontrollable and unexpected demand or cost conditions.

When predatory pricing allegations have been made over a period of years, the scope of any assessment of the validity of those allegations must be expanded to encompass the alleged predator's price/cost relationship over a longer time frame. Otherwise, the analyst may be searching for the cause of the subsidization allegations after the effects of the anticompetitive behavior have already begun to be realized. Stated differently, if the alleged predator's prices and costs are compared after predation has ended and the benefits of the anticompetitive pricing scheme have begun to be realized (i.e., prices are now equal to or above costs), then that investigation will erroneously conclude that predation has never taken place.

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*/ Caves, Richard E., Air Transport and Its Regulators, Harvard University Press, Cambridge, MA (1962) p. 79.

Similarly, it should not be anticipated that all large firms in a market will engage in predation and subsidization at the same time. This would occur only if some form of collusive agreement were in effect or if the dominant firms in the market were setting prices in conformance with the strategic interdependence oligopoly pricing model. Therefore, it would be erroneous to conclude that predation and subsidization are not taking place simply because it cannot be shown that all large firms in the market are engaging in predatory pricing.

Given this analytical framework, one could then proceed to investigate the potential for predatory pricing and subsidization by integrated refiners of their company operated retail gasoline outlets along the following lines:

(1) First, identify those integrated refiners with sufficient financial resources and staying power to engage in a sustained predatory pricing campaign of perhaps as long as one year. This list of potential predators is not likely to include all integrated refiners. This is because, while there are 72 integrated refiners in the U.S., the 40 largest integrated refiners account for 95 percent of total domestic gasoline production;

(2) Various types of direct evidence, such as internal financial planning, marketing and corporate strategy documents often contain statements which describe a firm's objectives and policies in its dealings with competitors. In addition, key corporate officials frequently discuss corporate strategies at informal meetings for which no record is made. Therefore, when predatory practices are suspected, the use

of subpoena powers to obtain corporate documents as well as interviews with or depositions of key corporate officials are appropriate avenues to pursue.

(3) Identify the period of time during which a predatory pricing scheme by some (but not likely all) integrated refiners may have been in effect;

(4) For a period of time significantly longer than that identified in (3), obtain detailed monthly price, cost (including all variable and "fixed cost" expense items), gross investment and sales gallonage data, by retail outlet, for each integrated refiner selling gasoline directly in the relevant market;

(5) For that same period of time, obtain comparable price, cost, gross investment, and sales gallonage data, by retail outlet, from lessee dealers and jobbers operating in the same relevant market; and

(6) Determine whether or not the wholesale price of motor gasoline sold directly to lessee dealers, company stores and independent jobbers is cost justified.

These data and evidence can then be analyzed to determine on a more fully informed basis whether predation and subsidization by refiners of their retail operations has taken place. As we shall see in Part III of this Report, the methodological approach adopted by the authors of the Title III study falls far short of that proposed here.

III. ANALYSIS OF DOE'S ANALYTICAL APPROACH AND MAJOR FINDINGS AND CONCLUSIONS

In conducting its Title III assessment of competitive issues in retail gasoline markets, the OC has relied primarily upon the following data and information:

(1) EIA-132, Retail Motor Gasoline Sales Survey, for the Fort Wayne, Indiana Standard Metropolitan Statistical Area. This form identifies the universe of retail outlets in Fort Wayne and provides general ownership and sales gallonage data, by station;

(2) EIA-148, Retail Motor Gasoline Cost and Revenue Survey, for the Fort Wayne, Indiana SMSA. This form is described by DOE as providing data on the profitability of retail outlets in Fort Wayne, by mode of operation; and

(3) EIA-151, Refiners and Wholesalers Gasoline Prices and Sales. This form provides information on market share changes, changes in allocations by class of purchaser, and pricing practices by channel of distribution, for every U.S. refiner of gasoline.

In addition to the sales, cost and pricing data described above, a series of regional hearings in eight cities, including Fort Wayne, were also conducted. Testimony from 89 representatives of integrated refiners, jobbers and members of the dealer class was presented at these public hearings, and excerpts from several of the hearings along with a complete transcript of the Fort Wayne hearing were presented in appendices to the Title III report. However, in our opinion, the record developed at these hearings was largely ignored by the authors of the Title III study. This serious omission will be discussed further in a subsequent section of this Report. We will now turn our attention to the three major issues addressed in the OC study.

A. Are Integrated Refiners Subsidizing Their Company Operated Gasoline Retail Outlets?

Through a census of retail outlets in the Fort Wayne SMSA, OC attempts to assess whether predation and subsidization by refiners of their retail operations have taken place in that market.*/ This assessment is primarily based upon what OC describes as "netback" calculations. As defined by the authors of the Title III study, an integrated refiner's netback from its own retail gasoline operations is the equivalent revenue left at the wholesale level after the costs of the retailing operation are excluded. More precisely, it is defined as the average retail pump price less the marketing expenses of selling through company-operated retail outlets. This netback is then compared to the wholesale price that the refiner charges for gasoline sold to other retailers or distributors. These prices received from wholesale purchasers are taken to represent the opportunity cost (i.e., foregone revenues) of the gasoline sold through company-operated retail outlets. If the netback received from retailing is less than this wholesale value of gasoline, then the integrated refiner is viewed as subsidizing its company-owned retailing outlets by accepting a lower return from them than by selling gasoline to other distributors. According to OC:

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*/ Fort Wayne, was only one of five SMSA's for which detailed operating data, by retail outlet, were collected by the DOE staff. However, due to time constraints, and unexpected problems in processing the data, the regional analysis presented in Part I of the Title III study was restricted to Fort Wayne. Comparable analyses of the other four regional markets are to be presented in Part II of DOE's Title III report to Congress later this year.

> If this adjusted pump price is above the wholesale price yardstick, then the hypothesis that refiners are subsidizing their retail operations can be rejected. On the other hand, if this adjusted pump price is below the wholesale price yardstick, then the hypothesis of refiner subsidization cannot be rejected. In this instance, a withdrawal from the retail market and an increase in wholesale level transactions would apparently increase the integrated refiner's profitability.*/

These netback calculations were performed by OC for six refiners who sold gasoline through company stores during calendar year 1978. According to the report's authors, the 1978 operations of only six refiners were analyzed because some firms refused to report the required data while the data submitted by others was unusable.

The wholesale price yardstick used in these calculations was dependent upon the type of refiner-owned retail outlet under consideration. If the particular outlet was a secondary brand, gasoline only station, then that refiner's wholesale, unbranded rack price was used as the appropriate yardstick price. On the other hand, if the refiner-operated retail outlet was a traditional, full-service station, then "an appropriate branded dealer price" (i.e., the dealer tankwagon price) was adopted as the yardstick for its netback calculations.

The Office of Competition calculated netback differentials for the six Fort Wayne refiners two ways:

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*/ U.S. Department of Energy, Office of Competition, Part I, The State of Competition in Gasoline Marketing, Washington, D.C. (May 1980) pp. 64-65.

(1) By including only variable expense items in the costs associated with marketing gasoline through refiner-operated outlets and;

(2) By adding several station-related fixed cost items to the variable costs used in the calculation of netback differentials under alternative (1).

The major variable cost items incurred at a gasoline retail outlet and used in these calculations are labor, utilities, maintenance and repair, credit card expenses and miscellaneous "other" expenses. Station-related fixed costs are local property taxes, equipment rental payments, mortgage expenses, lease costs and station rentals.

The netback differentials calculated by OC are summarized in Table 1. As shown there, when only average variable costs are included, three of the four refiners for which these calculations were made appear to have experienced positive differentials during 1978. Similarly, when selected station-related fixed cost items are also included, four of the six integrated refiners analyzed by OC showed positive netback differentials during 1978. On the basis of these results, the authors of the Title III study concluded that:

> An examination of these (netback) differentials shows that the refiners with the lowest prices at their company stores are also earning a positive return at those outlets. Those refiners losing money at their company stores are selling at relatively high prices at those outlets and have relatively high unit costs. This pattern is inconsistent with the hypothesis of predatory subsidization.*/

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*/ U.S. Department of Energy, Office of Competition, Part I, The State of Competition in Gasoline Marketing, Washington, D.C. (May 1980) p.iii.

Table 1

DOE Calculations of Netback Differentials
For Six Refiners In Fort Wayne, Indiana

1978

Company Code	Average Retail Selling Price (Rank Order)	Station Operating Cost (Rank Order)	Netback Differentials	
			Excluding Fixed Costs In ¢/gal.	Including Selected Station-Related/ Fixed Costs In ¢/gal.
A	1	N/A	N/A	(1.213)
B	2	1	(0.608)	(1.043)
C	3	3	1.489	0.773
D	4	5	1.060	0.910
E	5	2	0.790	0.540
F	6	4	N/A	0.594

( ) denotes negative netback differential.

Source: U.S. Department of Energy, Office of Competition, Part I The State of Competition in Gasoline Marketing, Washington, D.C. (May 1980), p. 73.

The authors of these statements are clearly in error. This is because their netback analysis reveals nothing about the extent to which refiners are "earning a positive return" or "losing money" at company-operated retail outlets. Indeed, if the investment costs associated with marketing operations were included in the analysis and if proper recognition were given to depreciation expenses (which represent a return of capital), management overhead at the corporate level allocable to marketing operations, or the bonded debt in the firm's capital structure, each of which represents significant expense items which must be included in any profit or loss calculation, then it could easily be shown that each of these six refiners would have been better off had they closed down their retail marketing operations altogether and operated strictly as wholesalers.

In our view, the exclusion of depreciation expenses, corporate overhead and interest on corporate debt from OC's netback calculations or the use of netbacks as a possible test for predation and subsidization without these major elements of station operating expenses are indefensible. The authors of the Title III report did attempt to justify the omission of depreciation charges from their analysis as follows:

> Depreciation charges are not included in the calculation of total station related operating costs. The data collected in Fort Wayne appears to be consistent among firms with the exception of depreciation expenses. These charges could not be interpreted in any consistent fashion.
>
> At the time of this publication, no useful way could be devised to adjust data to facilitate comparisons. Depreciation appears to be more a matter of accounting and corporate policy than an item reflecting the actual economics of the retail outlet . . . Even if depreciation charges were included, the conclusion drawn from the Fort Wayne data, however tentative, would not change. The allocation of depreciation expenses makes netback analysis

> dependent on the accounting practices of the firm studied, instead of reflecting the underlying economics.*/

This attempted justification for failing to include depreciation charges is totally without merit. One does not ignore a major cost item simply because a precise quantification of that expense is unavailable. The authors of the Title III study should have either designed a method for developing reasonable estimates of depreciation expenses or, if that were not possible, they should have abandoned their netback analysis as a meaningful test of predation and subsidization in the Fort Wayne market.

Similar arguments can be made with respect to the failure to include the costs associated with management overhead at the corporate level or the interest expenses on the corporation's bonded indebtedness, portions of which should properly be allocated to the direct retail marketing segment of the integrated firm's business. Indeed, corporate overhead items, such as general and administrative expenses, advertising and the accounting costs associated with credit card purchases are typically advanced as a major justification for observed differentials between wholesale rack prices charged to unbranded jobbers and the dealer tankwagon prices paid by lessee dealers. It follows, therefore, that these costs must also be included in the calculation of refiners' netback differentials if that measurement is to serve any useful purpose.†/

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*/ U.S. Department of Energy, Part I, The State of Competition in Gasoline Marketing, Washington, D.C. (May 1980) p. 74.

†/ Although the Title III report does not contain detailed statistics on this point, it appears that the netback for most refiner-operated outlets was calculated relative to the wholesale rack price, not the higher tankwagon price. Thus, the netback, so calculated, does not reflect these costs.

Even if all appropriate cost items had been accurately measured and included in OC's netback analysis, we believe that the use of netback differentials would still represent an inadequate test for predation and subsidization. This is because:

(1) First and foremost, netback analysis fails to address the extent to which a potential predator may be earning a reasonable rate of return on its investment in gasoline retailing operations. The ability to recover all costs and to earn a rate of return commensurate with the risks involved is, of course, the only justification for a firm to remain in business in general or in a more narrow line of operations in particular. In this connection, it must also be recognized that predation can take place even if a firm is earning some positive return on its stockholders' investment, albeit a lower rate of return than the firm's required cost of capital. Therefore, the only valid test of potential predation and subsidization is one which also focuses upon the rate of return on investments in gasoline retailing operations, as opposed to a simple comparison of sales prices against operating expenses and some hypothetical yardstick designed to approximate the opportunity cost of remaining in the gasoline retailing business.

(2) An upward bias in the computation of netback differentials was created by assigning lower wholesale rack prices (as opposed to higher dealer tankwagon prices) to 100 percent of the volumes sold at refiner-operated, unbranded

gas only outlets. A more reasonable allocation of those volumes would result if it were assumed that a major portion of gasoline sales to be diverted from refiner-operated outlets would be channeled to ultimate consumers through the remaining station network in Fort Wayne. This is particularly true when it is recognized that (1) jobber/chain retailers (i.e., those who pay lower rack prices) accounted for only 16.3 percent of total retail gasoline sales in Fort Wayne in 1978 and (2) that dealers (i.e., those who pay substantially higher tankwagon prices) accounted for 41.8 percent of all retail gasoline sales in Fort Wayne during that same period of time.

(3) Even if it had been shown that some integrated refiners in Fort Wayne were earning adequate rates of return on their company-owned retail operations in 1978, that finding would not have provided adequate proof that predation and subsidization had not taken place during the years immediately prior to 1978. This is becuase an equally plausible explanation of adequate earnings levels at the remaining outlets in Fort Wayne is that refiners had begun to enjoy in 1978 the fruits of their predatory pricing tactics during 1976 or 1977. Simply stated, a single twelve-month period is too short a period of time for a proper test of predation and subsidization.

(4) The authors of the Title III study made no attempt to distinguish between refiners who possess the necessary financial resources and staying power to

engage in subsidization over a sustained period of time and those who do not. Indeed, the names of the six refiners whose Fort Wayne operations were analyzed are not revealed in the DOE study. However, DOE did identify several refiners against whom charges of subsidization in their Fort Wayne had been made. These seven refiners were Ashland, Citgo, Clark, Koch, Marathon, Mary Hudson and Rock Island, none of whom are among the fifteen largest domestic integrated petroleum companies. While we recognize that companies such as Marathon, Ashland and Cities Service may be capable of engaging in predatory pricing campaigns, we seriously doubt whether firms such as Mary Hudson, Koch or Rock Island Refining would benefit enough to unilaterally contemplate, much less be able to sustain, a successful predatory pricing effort. Moreover, as stated at page 76 of the Title III study, some of the six refiners included in the analysis do not have any open or lessee dealers in Fort Wayne. These refiners would presumably have less of an incentive to engage in predatory pricing than would refiners with a substantial dealer network.

B. Is There Evidence that Refiners in Fort Wayne are Earning Adequate Rates of Return on their Investment in Gasoline Retail Operations?

As was discussed in the previous section, netback analysis provides an inadequate measurement of whether or not refiners are making or losing money in their retail operations. However, there does exist within the Title III study sufficient revenue and cost data to permit one to reasonably estimate profitability in refiner retailing in that market during 1978. These data are presented in Tables 3-3 and 3-4 of the OC study. Specifically, the operating data presented there for refiner-operated "gas only" and "non-conventional" stations can be used to prepare a monthly operating statement for a typical refiner-operated, gas only station during calendar year 1978.

As shown in Table 2, a typical refiner-operated, gas only station in Fort Wayne lost $831 per month during calendar year 1978. This calculation was made as follows:

(1) Average monthly revenues, product costs, current operating expenses and station-related fixed expenses were taken directly from Table 3-3 of the Title III study;

Table 2

Aggregate Average Monthly Profit and Loss
Statement for Refiner-Operated Stations in Fort Wayne

	1978	Per Gallon
Average Revenues	$48,366	$.594
Less Expenses		
Product Costs	$44,376	$.545
Current Operating	3,257	.040
Station-Related Fixed	488	.006
Depreciation	369	.005
Overhead, G&A, etc.	407	.005
Interest	300	.004
Total Expenses	$49,197	$.604
Net Revenue	($831)	($.010)

( ) denotes net loss.

(2) Overhead, G&A expenses, etc. were estimated at 0.5¢ per gallon. Based upon our experience with petroleum company accounting procedures, this is a conservative estimate of this expense item. In addition, the OC study itself contains estimates of corporate overhead expenses for nonconventional refiner-operated retail stations. These estimates are presented in Exhibits X and XIV of Appendix B of the Title III study, which show estimates of 2.4¢ and 1.0¢ per gallon for corporate overhead at high-volume, nonconventional refineroperated retail outlets during 1978. However, so as to ensure that we have not overstated this expense item, we have used only 0.5¢ per gallon in the analysis presented in Table 2.

(4) Monthly interest expense was estimated by assigning a debt/equity ratio of 30 percent to an integrated petroleum company's total investment in marketing facilities. This is the average debt ratio for all major integrated petroleum companies. An average annual interest expense of 8.0 percent was then assigned to 30 percent of $150,000, which is the market value of an average refiner-operated station in Fort Wayne presented at page 85 of the DOE study. This results in monthly interest expense for refiner-operated stations of $300 (i.e., $\frac{.30\ (\$150{,}000)\ \text{x}\ .08}{12}$).

The operating revenue and cost data presented in Table 2 can also be used to calculate the average sales price that would be required if equity investors were to earn a reasonable rate of return -- after payment of state and federal income taxes -- on their investments in refiner-operated retail stations. An estimate of that required after-tax rate of return is 15.0 percent, which is below the average after-tax return on common equity earned by the Standard & Poor's 400 Industrials in 1978. As shown in Table 3, the average sales price at refiner-operated gas only retail outlets in 1978 would have to have increased to 63.6¢ per gallon for equity investors in those stations to earn after-tax returns of 15.0 percent. This calculation was made by using the same cost items presented in Table 2 and by assuming that average federal and state income taxes were 50.0 percent of pre-tax net revenue, which approximates the statutory tax rates then in effect.

The calculations presented in Tables 2 and 3 show that:

(1) On average, integrated refiners' gas-only retail outlets operated at a loss during 1978; and

(2) Average prices at those same refiner-operated, gas only retail stations should have been at least 4.2¢ per gallon higher for equity investors in those stations to have earned a reasonable rate of return on their investment.

Our estimates of the amount by which refiners seem to have underpriced their gasoline at company stores in Fort Wayne are probably conservative. For example, we used $150,000 as the average 1978 market value of refiner-owned and operated, gas only outlets in Fort Wayne. High volume retail outlets in metropolitan areas typically cost more than that today. For example, as shown in Appendix B to the Title III study:

> The costs of land and improvements vary from a low of $50,000 to a high of $400,000 based on when and where they were built. The facility costs in 1960 for one major oil company, for example, averaged $81,000.

By 1968, this same facility on a slightly larger piece of land cost $130,000. Current costs would approximate $350,000 - $500,000. */

Table 3

Aggregate Average Monthly Profit and Loss Statement for Refiner-Operated Gas Only Stations in Fort Wayne if Equity Investors are to Earn 15.0 Percent After-Tax Returns

(1978)

		Per Gallon
Average Revenues	$51,821	$.636
Less Expenses		
Product Costs	44,376	.545
Current Operating	3,257	.040
Station-Related Fixed	488	.006
Depreciation	369	.005
Overhead, G&A, etc.	407	.005
Interest	300	.004
Total Expenses	$49,197	.604
Net Pre-Tax Income	$ 2,624	$.032
State & Federal Income Taxes	$ 1,312	$.016
Net After-Tax Income	$ 1,312	$.016
Station Investment	$150,000	
Percent Equity Investment	70.0%	
Equity Investment	$105,000	
Annual Rate of Return on Stockholder's Equity	15.0%	

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*/ Ryan, Thomas C., "Description of Types of Gasoline Retail outlets", Appendix B to Department of Energy, Part I The State of Competition in Gasoline Marketing, Washington, D.C. (May 1980), p. 5. Ryan points out that stations outside metropolitan areas generally cost less than those in urban or suburban areas and that a reasonable current estimate of average embedded gross investment costs for a large company with many retail outlets is about $130,000. This figure, which represents an average for all locations -- both rural and urban -- would be well below the true value or opportunity cost of a high volume, gas only outlet in a standard metropolitan statistical area such as Fort Wayne.

Similarly, the average monthly depreciation expense used in our analysis ($369) is quite low, relative to those presented in Appendix B. This is also true for corporate overhead expenses allocable to the station.

Lastly, as was previously stated, we have used 0.5¢ per gallon for corporate overhead and G&A expenses properly allocable to the retail outlet and this amount is likely to be well below actual overhead and G&A expenses at stations owned by integrated refiners.

C. Are Integrated Refiners Moving Gasoline Away From Their Branded Dealer Network Into Their Own Retail Outlets?

Between 1972 and 1978, the total number of retail outlets in the U.S. supplied by the 40 largest refiners and operated by lessee and open dealers declined from 191,580 to 111,923. As a result of that dramatic decline in dealer-operated outlets and the concomitant expansion of retail operations by integrated refiners, many dealers and dealer organizations have charged that integrated refiners have moved substantial quantities of gasoline away from their dealers and into their own company stores. For example, earlier this year, the Georgia Association of Petroleum Retailers, Inc. stated the following:

> As a hundred thousand branded stations were closed . . . their volume reverted back to the major refiners. Instead of fairly reallocating that product across all stations, the majors took advantage of the fact that this volume was not tied down to particular stations, and they programmed it through new and existing company operated units.*/

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*/ Allvine, Houston & Phillips. The Case for Legislative Relief from the Impending Destruction of Small Businesses and Competition in the Gasoline Industry, Decatur, Ga. (January 1980) p. 68.

The authors of the Title III study are unable to find any support for these charges. They simply explain them away by observing that, while a large number of dealers have indeed gone out of business since 1972, average monthly sales volumes at the remaining dealer outlets has increased since then. To illustrate:

> Table 2-3 indicates that there has been a dramatic decrease in the number of retail outlets supplied directly and operated by lessee and open dealers. However, the average monthly volume of gasoline sales has increased for the remaining dealers in business. It would appear that at least the four largest refiners are not closing dealeroperated stations and funneling the gasoline that had been sold at these stations through their company stores. For these companies, which account for almost 50 percent of gasoline sales to dealers, total monthly sales to dealers as a group have actually increased in 1978 relative to 1972. For Group II (the fifth through eighth largest refiners), sales to dealers collectively fell about 128 million gallons per month over the 1972-78 time period. This amounts to approximately 250 gallons per month for every lessee and open dealer they supplied in 1978. One could not conclude on the basis of this slight decrease that these companies channeled substantial amounts of gasoline away from their dealer network into their company stores. */

Our first comment is that the decrease in gallons sold per month by refiners to lessee and open dealers, divided by the number of lessee and open dealers remaining in business in 1978, is a meaningless statistic. It provides no useful information about the extent to which integrated refiners may have diverted gasoline away from their dealers and into their company stores. Second, the OC calculation of that statistic, i.e., "approximately 250 gallons per month for every lessee and open dealer they supplied in 1978", is incorrect. The correct amount is 2,926 gallons per month for dealers supplied by Group II refiners.

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*/ U.S. Department of Energy, Part I, The State of Competition in Gasoline Marketing, Washington, D.C. (May 1980) pp. 44-46.

We have prepared Table 4 so as to present an alternative interpretation of recent trends in refiners' sales to company stores and dealers. As shown there:

(1) For the nation's four largest refiners, total sales to lessee and open dealers increased between 1972 and 1978. Moreover, sales to company stores for this refiner group increased only marginally over that same period of time. Thus, it does not appear that the four largest refiners have channeled substantial quantities of gasoline away from their dealers and into their own company stores;

(2) The increase in sales to company stores as a percent of the decrease in sales to dealers for Group II refiners was 82.6 percent between 1972 and 1978. This indicates that these refiners satisfied a large proportion of the increased sales requirements at their own company stores out of the decrease in sales to their dealers since 1972; and

(3) Similarly, the increase in refiners' sales to company stores between 1972 and 1978 was 126.5 percent of the observed decrease in their sales to dealers over that same period of time. Thus, it is possible that a large portion of these refiners' increased sales requirements between 1972 and 1978 was satisfied through decreased deliveries to former dealers who have subsequently gone out of business.

Table 4

Trends in the Average Monthly Sales Volumes and Number of Retail Outlets Supplied Directly by the Leading Refiners 1972-1978

Line No.	Refiner Groups	Refiner Company Stores			Lessee and Open Dealers			Increase at Company Stores as a Percent of Decrease At Dealers Stations
		1972	1978	Increase/ (Decrease)	1972	1978	Increase/ Decrease)	
	Group I (Top 4)							
1.	No. of Outlets	2,307	1,251	(1,056)	69,278	44,485	(24,793)	
2.	Average Monthly Volume (1000 gal)	49.2	94.6	45.4	21.7	34.7	13.0	
3.	Total Monthly Volume (1000 gal)	113,504	118,345	4,841	1,505,633	1,542,390	36,757	N/A
	Group II (5th through 8th Largest)							
4.	No. of Outlets	907	1,917	1,010	71,684	43,830	(27,854)	
5.	Average Monthly Volume (1000 gal)	55.3	81.4	26.1	17.4	25.6	8.2	
6.	Total Monthly Volume (1000 gal)	50,157	156,044	105,887	1,251,010	1,122,756	(128,254)	82.6
	Groups III-VIII (9th through 40th)							
7.	No. of Outlets	8,307	10,622	2,315	50,618	23,608	(27,010)	
8.	Average Monthly Volume (1000 gal)	46.0	79.7	33.7	20.0	27.4	7.4	
9.	Total Monthly Volume (1000 gal)	382,434	846,738	464,304	1,013,164	646,129	(367,035)	126.5
	All Groups							
10.	No. of Outlets	11,521	13,790	2,269	191,580	111,923	(79,657)	
11.	Average Monthly Volume	47.4	81.3	33.9	19.7	30.0	10.3	
12.	Total Monthly Volume (1000 gal)	546,095	1,121,127	575,032	3,769,807	3,311,275	(458,532)	125.4

Source: Allvine, Houston & Phillips. The Case for Legislative Relief from the Impending Destruction of Small Businesses and Competition in the Gasoline Industry, Decatur, Ga. (January 1980) p. 45.

The data shown in Table 4 indicate that at least some refiners in Groups II through VIII may have fulfilled increased supply requirements at their company-operated retail outlets through supply volumes made available as nearly 55,000 of their lessee and open dealers went out of business between 1972 and 1978.

In this connection, it must be stated that we should not expect that all integrated refiners are or have engaged in predatory or discriminatory tactics towards their competitors. Therefore, the aggregation of average profit data or monthly sales statistics over a large number of refiners (as was done by DC in its analyses of the Fort Wayne data and trends in national sales by channel of distribution) is not likely to reveal potential predation, discriminatory practices or other forms of anticompetitive conduct, even if some refiners have indeed engaged in such practices. Thus, the failure of the authors of the Title III study to focus upon individual refiners in their assessment of the extent to which integrated refiners may be diverting gasoline supplies away from dealers and to their company stores represents a major flaw in their analysis and renders all conclusions on this subject invalid. This same criticism applies to the assessment of national trends in gasoline sales by channels of distribution contained in the Title III report.

D. Is There A Massive Nationwide Movement By Refiners Towards Company Store Operations?

The authors of the Title III study conclude that there is no massive movement toward company store operations by integrated refiners. They also arrived at a similar conclusion in a preliminary study earlier this year:

> On the basis of our preliminary research, we could not support the hypothesis that there is an industry-wide movement to refiner operated outlets. */

These conclusions derive from an analysis of national industry-wide data for the period 1972 through 1979. Specifically, OC relies upon the following statistics for the nation's 28 largest refiners in arriving at virtually all of its conclusions on this subject:

(1) In 1972, these refiners sold 6.6 percent of their gasoline through company-operated outlets. By 1979 this figure had risen to 11.0 percent;

(2) In 1972, these same refiners sold 20.9 percent of their gasoline to branded jobbers. By 1979, this figure had risen to 28.0 percent; and

(3) Unbranded sales to independent marketers accounted for 12.1 percent of total sales by the top 28 refiners in 1972. By 1979 this figure had risen to 18.4 percent.

Thus, OC concludes that the increase in the relative share of sales by refiners to their own stations has been less than the increase in the relative share of their sales to jobbers and unbranded marketers and that:

> The hypothesis that refiners are pushing dealers out of business must be tempered by the realization that other small independent businessmen have grown more than refiners' retail operations. †/

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*/ Fenili, Robert N. and Delaney, James B., TRENDS IN COMPANY STORES: A Preliminary Analysis, Department of Energy, Washington, D.C. (December 1979) p. 5.

†/ U.S. Department of Energy, Part I, The State of Competition in Gasoline Marketing, Washington, D.C. (May 1980) p. 33.

This analysis is misleading. For example, we know from OC's earlier study that total gasoline sales by the top 28 refiners increased 25 percent between January 1972 and January 1979. Given that information, it is possible to calculate approximate annual percentage increases in total refiner sales, by channel of distribution. These calculations are presented in Table 5. As shown there, during the period 1972 through 1979, total sales by refiners to company-operated outlets increased 108.3 percent, which is greater than comparable percentage increases to any other channel of distribution. Thus, in terms of relative growth since 1972, refiner sales to their own company stores have increased more rapidly than their sales to any other channel of distribution.

Table 5

Estimated Percent Increase In Refiner Sales, By Channel Of Distribution, 1972-1979

Channel of Distribution	1972		1979		Percent Increase 1972-1979	
	Relative Share (%)	1000 Gal.	Relative Share (%)	1000 Gal.	Relative Share	Sales
Direct Sales to End Users	9.6	7,680	5.7	5,700	(40.6)	(25.8)
Sales to Company Stores	6.6	5,280	11.0	11,000	66.7	108.3
Sales to Dealers	50.7	40,560	36.9	36,900	(27.2)	(9.0)
Sales to Branded Jobbers	20.9	16,720	28.0	28,000	34.0	67.5
Unbranded Sales to Independents	12.1	9,680	18.4	18,400	52.1	90.1
Total	99.9	80,000	100.0	100,000 */	25.0	25.0

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*/ Estimate based upon January 1979 sales of top-28 refiners of 8.4 million gallons (see Trends In Company Stores, p. 5.

Of even greater significance, however, is the dramatic expansion by certain refiners into direct retail operations. This was recognized by OC in TRENDS IN COMPANY STORES but totally ignored in the recent Title III study. To illustrate, in January 1972 the top 28 refiners sold 458 million gallons of gasoline through company stores. By January 1979, this figure had increased by 102.1 percent to 925.8 million gallons. That increase, in-and-of itself, is substantial. However, the increase in direct retail operations of specific refiners since 1972 is far more indicative of potential competitive problems in retail gasoline markets. This can be seen by reference to Table 6.

As shown in Table 6, eight firms account for 88.7 percent of the observed increase in refiner sales to company-operated retail outlets since 1972. More specifically:

(1) Gulf, Marathon, Clark and Sohio BP increased their sales to company-operated outlets 521.4 percent and as a group these four firms accounted for 65.0 percent of the total increase in top 28 refiner sales to company stores since January 1972; and

(2) Citgo, Mobil, Crown and Hess increased sales to company stores 432.3 percent and their combined increase accounts for 23.7 percent of the total increase in sales to company stores by the top 28 refiners.

Table 6

Who Accounts For The Volume Increase In Refiner-Operated Retail Outlets Among The Leading 28 Domestic Refiners

(Sales Volumes In Millions Of Gallons)

Refiners	Sales Volumes January 1972	 January 1979	 Increase	Percent Increase	Increase As Percent of Total Increase
Gulf Marathon Clark Sohio BP	58.3	362.3	304.0	521.4	65.0
Citgo Mobil Crown Hess	25.7	136.8	111.1	432.3	23.7
Subtotal	84.0	499.1	415.1	494.2	88.7
Total Top 28 Refiners	458.0	925.8	467.8	102.1	100.0

Source: Fenili, Robert N. and Delaney, James B., TRENDS IN COMPANY STORES: A Preliminary Analysis, Department of Energy, Washington, D.C. (December 1979) p. 4.

As was discussed in a previous section of this Report, we should normally not expect all large firms in an industry to act in concert in their pricing, output or marketing decisions. Therefore, it is not surprising to observe that some integrated refiners are expanding the scope of their marketing operations while others are experiencing little or no change. However, the dramatic and rapid increases in sales at company stores for the eight firms shown in Table 6 should be viewed as a genuine cause for concern. This is because, when it is also recognized that the total size of the market for gasoline is limited, similar rates of growth by other refiners in the future could easily result in unacceptable levels of seller concentration in this industry.

E. Does The Title III Study Represent An Analysis Of Competition In The Gasoline Retailing Industry?

The Title III study is entitled The State of Competition in Gasoline Marketing: The Effects of Refiner Operation at Retail. As was recognized by the staff of the Federal Trade Commission, the report's claim that it analyzes competition in gasoline marketing is not fulfilled:

> The issue analyzed in the DOE report, then, is not whether the petroleum industry or the retailing segment of the petroleum industry is competitively or monopolistically structured. Normally an analysis of the state of competition in a market would examine such issues as whether firms in the industry are earning excess profits and whether or not entry into the industry is difficult. An analysis of concentration and whether there are enough firms in the industry to promote effective competition is usually included as well. Behavioral issues such as how prices are set in the industry and how much advertising or research and development firms in the industry undertake would also be analyzed. In addition, a competition analysis might examine whether special features of an industry -- such as the large number of lessee dealers operated by the major refiners prior to 1972 -- is a result of a fewness of firms

> in the industry or the form competition takes in the industry. These issues are not analyzed in the DOE report. */

We also concur with the FTC staff in its recognition that the absence of predation does not mean that an industry is competitive. This observation is particularly applicable to the retail gasoline industry, which is totally dependent upon integrated refiners for nearly all of its primary supplies, i.e., motor gasoline. Thus, an integrated refiner need not sell below costs at company stores if its objective is to drive competitors out of the market. Indeed, a far more rational strategy for such a firm would be to artificially inflate the price paid by its lessee dealers (and perhaps its wholesale unbranded customers) such that they are unable to compete effectively with company-operated outlets even if prices set at company stores are profitable. This is precisely the charge which has frequently been advanced by a large number of lessee dealers, jobbers and independent marketers, and which was virtually ignored in the Title III report.

To illustrate the significance of this point, consider the following 1978 product prices paid by gasoline retailers in Fort Wayne:

(1) Conventional Lessee Dealers -- 58.1¢
(2) Conventional Open Dealers -- 57.9¢
(3) Jobber/Chain Retailer Gas Only Outlets -- 55.1¢
(4) Refiner, Gas Only Outlets -- 54.5¢; and
(5) Refiner-Operated, Nonconventional Company Stores -- 54.4¢

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*/ Anderson, Keith B. and Phelps, John. Comments Of The Bureau Of Economics, Federal Trade Commission, On The State Of Competition In Gasoline Marketing; The Effects Of Refiner Operation At Retail, Washington, D.C. (June 1980), pp. 3-4.

These data indicate that lessee and open dealers in Fort Wayne were charged by refiners 3.4 - 3.7¢ more per gallon than the transfer price paid at refiner-operated outlets. In view of the fact that transportation costs from the refiner to the dealer are typically less than 1.0¢ per gallon and that, according to the Title III study, average monthly depreciation expenses at refiner-operated, nonconventional outlets were only 0.4¢ per gallon in 1978, this markup over intracompany transfer prices appears far too high.

Similarly, there is no apparent justification for the 0.7¢ per gallon differential between wholesale prices paid by jobbers and chain retailers in Fort Wayne and the transfer prices paid at refiner-operated company stores.

At the Fort Wayne hearings, lessee dealers and independent marketers presented evidence on prices they paid for product and the retail prices charged at refiner-operated outlets. These price surveys showed that on numerous occasions, wholesale prices being charged by refiners were moving upward while at the same time they were reducing pump prices at their own retail outlets. To illustrate:

> Please also note on Table VIII the number of times that Marathon raised their price to their unbranded jobber customers and to the Marathon Dealers in Fort Wayne, without making a corresponding increase in their direct salaried retail price . . . . Furthermore, please note that . . . they actually lowered their retail price at their direct salaried stations while increasing the price to their independent dealers and unbranded jobbers. */

To the extent that these types of situations are common and that the prices charged to lessee dealers and independent

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*/ Testimony of Robert J. Thornhill, President, Thornhill Oil Company, Inc., Before the Department of Energy at public hearings in Fort Wayne, Indiana, August 21, 1979.

markets are not cost justified, then it makes little difference whether we label that type of anticompetitive pricing by refiners predation or a classic example of the price squeeze. The effect on competition is the same in either case: rivals are unable to compete with their integrated suppliers and ultimately will be driven from the market. Therefore, the failure of the authors of the Title III study to analyze the pricing practices of integrated refiners in their transactions with competitors is a major shortcoming of the study which we believe completely undermines all of the report's conclusions on the state of competition in gasoline marketing.

IV. CONCLUSION

Having concluded that there is no evidence of anticompetitive subsidization by refiners of their retail operations or of a massive movement by refiners into direct ownership and operation of retail outlets, the authors of the Title III study trace the current plight of independent gasoline dealers to changed market conditions and an inherent rigidity in DOE's price and allocation regulations. We believe that the Title III analysis placed excessive emphasis on attempts to justify why literally tens of thousands of dealers are leaving the business and far too little effort on the development of a detailed and thorough analysis of the potential for anticompetitive conduct in this industry.

The changed market conditions hypothesis advanced by OC is that, in today's market, refiners and other large volume marketers of gasoline are relatively more efficient than lower volume lessee and open dealers. Thus, according to this argument, the large number of lessee dealers leaving the market in recent years is but a manifestation of natural competitive forces which result in high cost, high priced operators losing their historic market shares to lower cost, lower priced competitors and unprofitable firms or stations ultimately closing down and going out of business.

We believe that the changed market conditions hypothesis set forth by DOE must be rejected. This is because:

(1) No complete analysis, including all relevant costs, of total profitability at refiner-operated stations in Fort Wayne is presented in the Title III study;

(2) The OC analysis does indicate that, on average, lessee dealer stations in Fort Wayne are profitable (see Table 3-4 of the Title III study); and

(3) As we have shown in Part III of this Report, reasonable estimates of all costs of doing business at high volume refiner-operated stations in Fort Wayne show these outlets to be losing money.

It follows, then, that if refiner-operated outlets are not profitable, the changed market hypothesis suggested by the authors of the Title III study represents an inadequate explanation of the observed growth in refiners' direct retail sales and of the ongoing exodus of dealers from the market. Thus, the question remains: Are integrated refiners subsidizing their company stores? And, as was discussed in Part III of this Report, the analytical approach applied by the authors of the Title III study to the available operating and market data represents an inadequate response to this question. Indeed, a reasonable alternative interpretation of these data is that serious competitive problems may exist in retail gasoline markets.

Appendix C.--Affidavit of Ward E. Bates

FEB 11 1981

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SUPERIOR COURT OF CALIFORNIA

COUNTY OF LOS ANGELES

RONALD E. CLARKE, et al., Plaintiffs, vs. GULF OIL CORPORATION, et al., Defendants.	CLASS ACTION NO. 000 319 DECLARATION OF WARD E. BATES IN SUPPORT OF PLAINTIFFS' REPLY TO DEFENDANTS' OPPOSITION TO MOTION FOR PRETRIAL HEARING ON CLASS ACTION ISSUES (Exhibit "C" to Reply Memorandum) Date : December 10, 1980 Time : 9:00 a.m. Dept.: 59

Attached hereto is the Declaration of Ward E. Bates in support of Plaintiffs' Reply to Defendants' Opposition to Motion for Pretrial Hearing on Class Action Issues.

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DECLARATION OF WARDEBATES

1. My name is Ward J. Bates, I reside at 25372 Champlain Road, Laguna Hills, Califonia, and I am a former GULF OIL COMPANY employee. If called as a witness I could and would competently testify of my own personal knowledge to the following facts:

2. I started my employment in the oil industry in the year 1958, when I was hired by Wilshire in the capacity of Wholesale Credit Manager for the Northern Region. Wilshire was subsequent purchased by GULF OIL. In 1960 I was transferred in the same capacity to the Southern Region of California. In 1961 I was transferred to Santa Rosa, California, in the capacity of retail marketer. From 1966 to 1967 I was assigned to the Real Estate Division of GULF in Santa Rosa. In 1968 I was transferred to the Seattle, Washington, region and there I again was assigned duties with Real Estate Department of GULF OIL. In 1973 I was transferred to the Southern California Real Estate Department. In 1974 I was made retail marketer in the Van Nuys district of GULF OIL COMPANY and I remained in that capacity until June 15, 1976, when I was terminated, allegedly due to injuries I sustained in an automobile accident.

3. While a retail marketer for GULF OIL COMPANY in the years 1974 and 1975 I was instructed by Mr. George Williams and Mr. Al W. Johnson, my superior, to eliminate every GULF lessee-branded dealer assigned to my jurisdiction. When I

inquired why this had to be done, Mr. George Williams informed me that the lessee-branded stations were needed for the Economy Oil department of GULF OIL and that it has been decided that GULF OIL does not need any retail lessee-dealers since it can increase its return on investment by either selling the lessee-branded sites or converting them to Economy. Mr. Williams and Mr. Johnson outlined to me the methods to be utilized in getting my lessee-branded dealers out of business as follows: (a) call the Santa Fe Refinery and hold up or delay shipment of gasoline to the dealers; (b) break the lessee-branded dealers financially by overloading them with TBA and thereby forcing them to make payments they could not afford; (c) withhold rental rebates from the dealers as long as possible and to force the dealers to purchase TBA with the proceeds from the rental rebates; (d) force the lessee-branded dealers by threat of non-renewal of leases to lower the retail prices of gasoline so as to make them more competitive, but reducing their profit margin, and thereby forcing them to abandon their stations; and (e) any other way I can think of.

4. I told both Mssrs. Johnson and Williams that in my opinion, their proposed methods were criminally illegal. Mr. Williams informed me that "such is life," and besides, "the legal department will handle it." I flatly told them that I refused to carry out such assignments.

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Subsequently, in the early part of 1975, Mr. O. D. Meyer, a senior GULF OIL executive informed me that the GULF executives in Houston were extremely upset about the slow rate of GULF dealer disappearance in California and that they could not understand how the dealers could resist the pressures we were supposed to put on them. Mr. O. D. Meyer stated that it was because of people like me, who had mispalaced loyalties, that the GULF program had bogged down. He informed me that that his own job was on the line because Houston was screaming at him. He informed me that before he loses his job, he would make sure that I go first. I once again told him that I refused to do anything illegal. Thereafter, Mr. O. D. Meyer and Mr. George Williams invited me to a meeting to give me a last chance to "see the light." Mr. Meyer told me at that meeting that it is GULF and not the dealers who pay my salary and that therefore I should be interested in GULF's profits and not the dealers' profits. I proposed to them that GULF offer each dealer a decent sum of money in order to get out of the station. Mr. Meyer told me that that is impossible since GULF must convert lessee-branded dealerships to Economny without a capital investment. I informed them that that was plain stealing. They then informed me that I was not, after all, a company man like 95% of the retail marketers who without any question carried out their orders.

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5. On June 17, 1975, I was called to the District Sales Office at Van Nuys, by Mr. George Williams, the District Sales Manager. Mr. Williams informed me that due to a need for "staff reduction" I was being terminated. On July 23, 1975, I was admitted to the Mission Community Hospital due to collitis. On July 6th, 1975, my physician certified me for work. On July 11, 1975, I telephonically spoke to Mr. George Williams, who expressed his sympathies and then told me that my termination was decided by O. D. Meyer acting on direct orders from Houston. Notwithstanding my "termination notice," I continued working as a retail marketer until I was involved in a serious auto accident. Following my discharge from the hospital, on March 28, 1976, I informed Mr. Al Johnson that I was ready to resume my employment. On or about June 15, 1976 I was officially terminated.

6. I participated in the GULF Divestiture Program in Northern California. At a Real Estate Sales meeting in Northern California attended by, among others, Mr. Robert ~~Bartel~~ BARTLETT GB, my supervisor, we were informed by senior real estate executives that the Divestiture Program in Northern Califonria was being carried out for the purpose of getting a tax advantage for GULF, but that GULF had absolutely no intention of leaving the Northern California market. The idea was, according to these gentlemen, to close and sell those stations that were low on gas and TBA volume and to convert the choice stations to Economy. We were given strict instructions to insert "petroleum restriction" clauses into all real estate sold so that no one could use the real estate in order to compete with GULF. The foregoing

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instructions were then discussed by me with Mr. Robert ~~Bartel~~ BARTLETT in detail. I followed these instructions and insisted that all escrows contain the petroleum restriction clause. Exhibit "A" to this Declaration is a communication authored and signed by me. The handwriting below and to the right of my signature is that of Mr. ~~Bartel~~ BARTLETT. I am familiar with and recognize it as his handwriting. Exhibit "A" pertains to the then proposed sale of station #1171, located in the so-called divestiture area of California. Some exceptions to the petroleum restrictions clause were permitted, upon clearance from Mr. O. D. Meyer or GULF executives in Houston. These exceptions were permitted if the proposed buyer was either the Holiday Inn, Inc., or its affiliates. Mr. ~~Bartel~~ BARTLETT told me that these exceptions were permitted because the Holiday Inns and GULF had interlocking financial interests.

7. In 1972, I attended a real estate meeting at GULF's headquarters in Century City. The following GULF personnel attended the meeting:

R. F. Bradley
L. M. Parkhurst
O. D. Meyer
C. R. Walshire
E. A. Sumpter
F. E. Pacheco
J. Gannaway
T. Olsonn
J. Chilton
F. Jacobs
E. Shumate
R. Bartlett
C. Sperl
W. Bates
J. Bertnick

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At that meeting we discussed the divestiture program. Mr. Bradley informed us that Mr. O. D. Meyer would be in charge of the program because of his great success in eliminating dealers in the Washington divestiture area. We were informed not to discuss the program with anyone other than GULF personnel assigned to the program. One of the reasons for silence, we were told, was based on the fact that only the major oil companies knew that there would be a gasoline shortage in the United States. Mr. Meyer personally told me that if the public or stockholder knew as to what the divestiture program was all about, it might affect GULF's publicly-traded stock. Mr. Meyer told me also that irrespective of the elimination of the lessee-branded dealers, GULF intends to sell as much gasoline as possible in California, but that the future prices will be enormously higher. At that meeting we were told that GULF will keep approximately 70 choice retail units in the divestiture area. We were also told by Mr. Bradley not to tell any of the dealers about the real purpose of the divestiture program. Exhibit "B" to this Declaration is a true copy of a follow-up communication received by me, from GULF, after the Century City meeting described above. Unfortunately, page two of said communication is missing and I have no independent memory of its contents.

8. Exhibit "C," "Projected Service Station Closures," dated December 12, 1973, is a communication that I have never seen prior to it being shown to me by the plaintiffs' lawyers on November 3, 1980. I declare that I am familiar with Mr. O. D. Meyer's signature, having seen it hundreds of times in the past.

I further declare that the signature depicted on page 2 of Exhibit "C" is the true signature of Mr. O. D. Meyer.

9. In the year 1975, I was personally informed by Mr. George Williams and Mr. O. D. Meyer that each lessee-branded dealer must sell TBA on a ratio basis in relation to the volume of gasoline sold. I was told by Mr. O. D. Meyer that Gulf was "shooting" for a 20-25% TBA ratio to gasoline sold by the lessee-branded dealers. I was instructed to inform the dealers that if they did not sell the required TBA, their leases were in jeopardy. I was further instructed by Mr. O. D. Meyer that once a dealer has succumbed to increasing his TBA ratio, we then must force the dealer to increase his sales of gasoline so that we can further load him up with TBA to match the TBA ratio with the new increased volume of gasoline. Mr. Meyer told me that following such a program, no dealer can stay in business. Exhibit "D" is a true and correct copy of year-to-date TBA and oil ratios kept by GULF in my district. I received these TBA ratio updates in the normal course of my employment. Both Mssrs. Meyer and Williams continually pointed out to me that I had the lowest TBA ratio in the district.

10. Mr. Williams and Mr. A. W. Johnson, GULF executives, instructed me to force the dealers to increase their hours of operation so as to force them to sell more gasoline, which in turn would force them to purchase more TBA. Exhibit "E" is a

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communication in that regard received by me in the normal course of my employment with GULF. I am familiar with and I recognize the signature as that of Mr. Al Johnson thereon.

11. Mr. Meyer and Mr. Williams also instructed me to "encourage" dealers to join the $10,000 TBA club. I was told by Mr. O. D. Meyer and others at GULF to tell the dealers that if they joined the $10,000 TBA club (purchased $10,000 worth of TBA per month), their leases were not in jeopardy and they had a future with GULF for as long as they wanted to stay in business. I told Mr. Meyer that since he had already told me that GULF intends to eliminate the GULF dealers from the California market, I would refuse to lie to the dealers in this manner. Exhibit "F" is a true and correct copy of a communication with attachments that I received in the normal course of my employment with GULF. Members of the $10,000, $20,000 and $30,000 TBA club in the Los Angeles district are listed therein.

12. Exhibit "G" are certificates and letters of recognition I received as a GULF employee.

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13. Exhibit "H," the Memo of June 23, 1978, is a communication I have not seen prior to this date. However, I am familiar with and recognize the signature and handwriting on the document as that of Mr. George Williams.

Executed at Laguna Hills, California, this 2nd day of November, 1980. I declare under penalty of perjury that the foregoing is true and correct.

Warde Bates

Ward Bates, Declarant

WB.

(Exhibits deleted)

WB.

APPENDIX D

RESTRICTIVE TRADE PRACTICES

REPORT OF
COMMISSION OF CANADA

"THE STATE OF COMPETITION IN THE CANADIAN PETROLEUM INDUSTRY"

(Excerpts from Volume I:

"Findings, Issues and Remedies")

Summary of Issues and Recommendations

The issues that are raised by this submission point to the need for remedies both of a general and of a specific nature. In the general context of competition legislation, the practices and conditions in the petroleum industry disclosed in this submission suggest the need for revisions to the *Combines Investigation Act*. In particular, amendments are required to improve the existing legislation with respect to predatory or exclusionary behaviour, parallel activities that promote monopolization, and the use by multinational firms of high transfer prices to exploit Canadian consumers.

It is recommended the marketing sector be restructured by divestiture of certain marketing assets of the majors. In addition, other remedies should be directed towards providing supply to the independent reseller sector — possibly by administrative actions and certainly by an expanded role for Petro-Canada. Finally, the present state of competition in the Canadian petroleum industry emphasizes the need for more effective regulation of the pipeline and refining sectors of the industry.

During the period under review, 1958-73, the monopolistic practices adopted by the four major petroleum companies — Imperial Oil Limited, Shell Canada Limited, Gulf Canada Limited and Texaco Canada Limited — varied from one sector to the next in this vertically integrated industry. Material on the international sector (Volume III) demonstrates that high prices were extracted from the Canadian consumer because most of the majors followed the same strategy of constraining the competitiveness of their Canadian subsidiaries by charging them higher transfer prices for their imports of crude oil than those prevailing in the world market. This practice flowed from the disciplined, tightly-knit oligopoly of the foreign parent companies.

To deal with the high transfer price problem, the Director recommends that:

Recommendation # 1:

> legislation be enacted to prohibit the payment of artificially high transfer prices by Canadian companies to foreign parent or affiliated companies where such practices adversely affect the Canadian consumer.

Effective legislation in this area will require specific provisions to obtain information from parties located outside of Canada. Accordingly the Director recommends that:

Recommendation # 2:

> legislation be enacted to grant the appropriate authorities the necessary power to obtain information that is stored abroad by the parent or affiliated company of a Canadian company, where that information relates to activities affecting competition in Canada.

Material on the domestic production sector (Volume IV), shows that competition was restrained by the pricing mechanisms that were adopted. These mechanisms, though tied to the need for shippers to batch crude oil streams, were also used to harmonize divergent company positions when jointly setting crude prices. The ability of these firms to jointly set prices was greatly facilitated by the major integrated petroleum companies' ownership and control of trunk pipelines.

To remedy this situation, the Director recommends that:

Recommendation # 3:

All petroleum pipelines under federal jurisdiction be actively regulated,

(a) to ensure that anyone seeking to ship special or batched streams of crude oil receive non-discriminatory access to the pipelines, and

(b) in a fashion that ensures that communications between crude oil shippers regarding pipeline operations are reduced to a minimum.

Recommendation # 4:

legislation be enacted requiring all major integrated oil companies to divest their holdings in all existing pipelines which are subject to federal jurisdiction, and that no major oil company be permitted to acquire a controlling interest in any new such pipeline.

In order to improve access to Alberta crude oil, the Director recommends that:

Recommendation # 5:

the Alberta Petroleum Marketing Commission modify its limitation on the number of eligible purchasers of Alberta crude oil.

The material on the refining sector (Volume V) shows that the refinery policies of the major integrated companies were directed towards the restraint of competition both from other refiners and potential entrants. Refinery supply agreements were the key facilitating mechanism for bringing refinery interests together. The majors' dominance of the refining sector enabled them, in the absence of access by independents to foreign product, to control both the volume of product supplied to and the price paid for product by non-integrated independent resellers.

Recommendation # 6:

legislation be enacted requiring that all refiners operating in Canada obtain approval of the National Energy Board for all refinery supply agreements affecting inter-provincial and international trade and exchange. Before approving such agreements the Board must consult with the Minister of Consumer and Corporate Affairs as to the likely effect the agreements may have on competition.

Recommendation # 7:

> legislation be enacted to expand section 31.2 of the *Combines Investigation Act* to provide for the issuance of interim orders for supply, at usual trade terms, pending final disposition of an application for an order to supply pursuant to section 31.2.

Material on marketing (Volume VI) demonstrates that parallel exclusionary policies were followed for more than fifteen years by the major integrated companies in the distribution of gasoline. When non-integrated firms offered little competition, each major established high wholesale/retail margins, choosing generally to compete among themselves only with respect to areas other than price. When non-integrated firms offered price competition, the majors adopted similar exclusionary practices aimed at disciplining these independent marketers and restraining or eliminating competition from this source. The common purpose and intent, the mutuality of interest, and the knowledge with which these exclusionary practices were designed and implemented characterizes a degree of co-ordination that resembles a shared or joint monopoly.

To reduce the potential for firms to pursue restrictive joint-monopolization practices, the Director recommends that:

Recommendation # 8:

> the *Combines Investigation Act* be amended to prohibit exclusionary practices adopted by a dominant firm, or two or more firms that are part of a group of firms that are dominant and to provide for orders to be made requiring that such firms divest certain assets.

To deal with the competition problems existing today in the petroleum industry the Director recommends that:

Recommendation # 9:

> legislation be enacted to foster competition in the marketing of petroleum products with the objective of increasing the independent reseller sector to the point where that sector markets at least one half the total gasoline and heating oil product sold in Canada, by;
>
> (a) requiring each existing integrated refiner of gasoline and heating oil to divest certain distribution assets or facilities in a manner which will ensure that, at the end of a five year period, the refiner is selling an equal amount of these products to independent resellers as it sells through its own remaining distribution network. For the purposes of these recommendations an independent reseller is defined as a distributor of gasoline and/or heating oil, with the following characteristics:
>
> (i) the refiner does not directly or indirectly control the distributor.
>
> (ii) ownership of the product is transferred to the distributor at a wholesale price that is determined independently of the retail price established by the distributor.

(b) requiring that any new refiner shall not sell more of its heating oil and gasoline output through its own distribution network than it supplies to independent resellers.

(c) assuring that supplies of gasoline and heating oil at non-discriminatory prices are available to independent resellers.

Recommendation # 10:

the government should provide financial assistance to service station dealers to acquire the divested distribution facilities of the refiners.

Recommendation # 11:

a major responsibility of Petro-Canada should be the expansion of its refinery operations in order to act as a supplier to independent resellers, whether or not the latter sell under the Petro-Canada logo.

The material and evidence contained in this submission indicates that, in the past, when the government intervened both directly and by regulation, in the petroleum industry, insufficient attention was directed to the effects such interventions had on competition. Given the vertically integrated nature of the industry and the dominance by a small group of firms, government intervention in fact facilitated the industry's exploitation of the Canadian consumer. Government intervention should be implemented in a fashion that reduces oligopolistic power and encourages competition. In light of the increasing role of government in the energy sector generally and the petroleum industry in particular, the Director recommends that:

Recommendation # 12:

greater attention should be given to the effect on competition of regulatory activity by government agencies. When alternative policies are available to meet government objectives, those policies which least restrict competition should be chosen. An analysis of the impact on competition of any policy should accompany all major regulatory proposals.

SUMMARY OF PREPARED STATEMENT OF JOHN J. FLYNN

Mr. Chairman and Members of the Committee:

My name is John J. Flynn and I am appearing here on behalf of the Service Station Dealers of America. I am an attorney, Professor of Law, and a student of antitrust law. I have prepared a lengthy statement analyzing the problems of petroleum retailers, justifications for divorcement of refiner-owned stations and the details of S. 326. I do not propose to read that statement, but submit it for the record to the relief I am sure of one and all. With the permission of the Chair and the Committee, I will briefly outline my filed statement, my analysis of the problems of the industry, the features of S. 326 designed to respond to the problems of retailers, some further comments on open supply and respond to any questions the Committee may have for me.

The first part of my statement summarizes the upstream structure of the petroleum industry. It describes the size and power of the major integrated petroleum companies; institutions which rank with nation states whether measured by their assets, revenues, employees, or their world-wide political and economic impact. The statement emphasizes this point because we often lose sight of the realities of the relationship between an individual retailer and a major oil company. It is not one of a freely arrived at bargain; it is not one of an on-going evenly balanced and arm's length relationship; it is not one where an independent entrepreneur is free to operate his business as he sees fit; and it is not one that fits any of the traditional concepts of contract law. One side of the bargain has all the power and clout; the other side none; one side dictates the terms of the relationship, the other can only acquiesce; one side can control the destiny of the other, while the other has little control over its own destiny.

The first part of my statement also outlines the horizontal interlocks between the major petroleum companies at every level of the market from crude to marketing. Horizontal interlocks, at least those which have been uncovered to date, include interlocks at the director level through banks, widespread joint ventures in production, joint ventures in bids for leases, almost uniform joint ownership of crude and product pipelines, and the widespread use of exchange agreements at the refining level. Walter Adams, a leading economist and student of the industry, has concluded after reviewing this high level of interlocks at every level of the business: "The claim . . . that the petroleum industry fits the structural model of effective competition is pure fiction." I would go a bit further because I know of no other industry which is so interconnected at every level and characterized by joint action in every activity from top to bottom. It is not an industry driven by competition, but on where cooperation and joint action are a way of life.

That conclusion, a conclusion I doubt few objective and knowledgeable observers would care to contest, leads into the next part of my statement: an analysis of the Final Report by D.O.E. on the State of Competition in Gasoline Marketing. The D.O.E. Report ignores the upstream structure and operation of the industry, while pursuing a narrow range of empirical inquiry at the retail level in a few local markets pursuant to abstract, unrealistic and artificial models detached from the reality they are intended to explain. The Report also purports to pursue the issue of subsidization or support of low prices at refinery-run outlets with profits from other markets or upstream profits squeezing branded dealers out of the retail market. The evidence D.O.E. relied upon was developed during a time-frame of extensive government regulation, shortage and rising prices. It looked only at the operation of retail outlets and ignored the upstream segments of the industry. My statement takes issue with both D.O.E.'s methodology and its conclusions in the area of subsidization -- a brief analysis I will not rehearse here. Professor Alvine has made a more elaborate study of these issues and is here to elaborate on the D.O.E. report. The statement also discusses D.O.E.'s analysis of predatory costing or the practice of refiners operating wholly-owned retail outlets while also supplying branded retailers at wholesale prices at or above the retail price they sell the same product at refinery-operated stations. The D.O.E. Report professed not to be aware of such a practice, nor to understand why a refiner would do such a thing.

Such a price squeeze is not as uncommon or strange as the D.O.E. Report would have one believe. It is a common practice where monopoly or powerful sellers compete with their buyers at retail because the squeeze of high wholesale prices to one's competitors can be used to take over the retail market, translate anti-competitive market power from one level of a market to another or manipulate buyers the refiner competes with to pump gas for little or nothing while the refiner realizes profits at wholesale and retail and maintains volume. Branded retailers are whipsawed by these unfair and predatory practices; practices the D.O.E. Report ignores because the Report is oblivious to the non-competitive structure of the industry and enraptured with proving the self-fulfilling prophecies of its irrelevant and abstract models. Apparently, reality and common sense have no place in supposed scientific studies such as this.

The reality of regional market power by control of refinery or pipeline terminals in connection with vertical integration by refiners into retailing requires divorcement of refinery operated outlets. Otherwise, vertical integration will wipe out retail competition in many markets dominated by a few refiners; retailers and jobbers will be and are being driven from the market by these practices; and, the consuming public is the ultimate loser because of a decline in competition in retailing. The statement outlines the price and other consequences of divorcement in some states where it has taken place under state law and the legal and economic arguments of opponents of divorcement which were used in the unsuccessful attempts to overturn state divorcement statutes. Needless to say, I find the analysis favoring divorcement convincing.

The final major section of my statement outlines S. 326, both the divorcement sections of the bill and the pricing sections of the bill. Once divorcement takes place, branded retailers still must face the problem of discriminatory pricing by suppliers. They will still be locked into a single channel of supply by their franchise and trademark license, while competitors are free to buy product at the best price they can. It is not unusual for gasoline refined at a particular refinery to be sold at a wide variety of prices; prices which fluctuate according to whether it is sold to locked-in branded dealers unable to buy product elsewhere; jobbers who may be accorded functional discounts and other discounts not related to any particular functional benefit they confer; prices to other major oil companies to supply their marketing outlets; and prices to independent retailers and jobbers buying on the spot market. The fallout effects of these various prices for the identical gasoline coming from a single refinery are apparent in the retail market. Branded retailers are locked out of buying product through channels other than those required by their franchisees and end up starting out of the gate in the race for the consumer's dollar with the highest wholesale price -- frequently a wholesale price equal to the retail price at branded or jobber-operated stations. When rents, franchise fees and credit card costs are added in, branded retailers find themselves even further priced out of the market. A current situation in Salt Lake City is not uncommon: branded retailers are charged $1.26 per gallon wholesale, while independent retailers are charged a wholesale price of $1.18 per gallon. One need not have a Ph.D. in economics to predict the marketing consequences of that kind of price discrimination. Section 2(b) of the bill is designed to equalize the branded retailer's access to the wholesale market, with due allowance for functional discounts to jobbers for legitimate functions performed and price reductions to meet, in good faith, competition. Unless something is done about discriminatory pricing practices the continued chaos and waste of dealer turnover will remain and competition will not determine success at retailing -- happenstance and economic power will.

The bill also gives branded dealers the right to buy product comparable in quality with that supplied by their franchisor and retail it from their stations so long as they do not misbrand it. I consider the open-supply provisions of the bill (Section 2(c)(1)) as important as the divorcement sections of the bill. Closing out franchised dealers from either buying product from the refinery they pull their branded product from except through the refinery mandated channels or from other sources which may be available to the dealer, is a practice which consigns franchised dealers to the status of a one-armed fighter with a tether around his neck. The other end of the tether is firmly held by the branded dealer's franchisor while refinery-operated retail outlets and jobbers with special discounts are free to pummel the branded dealer at will with lower priced gasoline. The branded dealer cannot respond because both his price and supply are under the control of his franchisor; a franchisor frequently competing against the branded dealer or supplying independent branders at prices the locked-in dealer cannot match because of high wholesale prices.

Freeing branded retailers so they can either buy their product from their franchisor's refinery source through other channels offering better terms or prices or so they can purchase product from other refineries or terminals so long as they do not misbrand the product at the franchised station, will both resolve many of the branded dealer's pricing problems and interject new competitive pressure upon wholesale and retail prices. Passage of this part of S.326 will immediately generate thousands of new potential competitors in the wholesale market for gasoline and enable franchised dealers to resist the overwhelming power and control of their franchisors as a result of being the dealer's sole source of supply by contract and not by competition.

No doubt the beneficiaries of the present system will claim that open-supply means the end of the franchise system or that it is contrary to the Petroleum Marketing Practices Act. The gist of a franchise method of marketing products is the partnership of franchisor and franchisee whereby they join hands under a trademark license and mode of doing business in bringing a product or service to the marketplace. Each side, in what is supposed to be a mutually arrived at bargain, benefits from the relationship; usually because it enables the franchisor to establish a widespread distribution system at less cost and with minimal risk and it allows franchisees to establish and operate an independent business with advantages of broad name recognition, widespread consumer acceptance and assets or services provided by the franchisor.

Open supply will make the rosy picture of the franchise-relationship more of a reality in the marketing of petroleum products. The open supply provisions of S.326 will provide a counterweight to the otherwise overwhelming power of the franchisor by enabling a retailer to buy product at the best price available, rather than be tied to a single source of supply by a lease or trademark license restriction. The Bill prohibits misbranding, so a dealer selling gasoline from sources other than his trademark licensor will only be able to sell the product from other sources if the pump it is sold from is de-branded. A dealer failing to do so may risk loss of the protection of the Petroleum Marketing Practices Act as well as violating S.326.

The legislative history of S.326 should make clear that a branded dealer taking advantage of Section 2(c)(1), the open supply provision, and not misbranding the product by selling it under the franchisor's trademark, does not lose the protections of the Petroleum Marketing Practices Act. Under Section 102 of that Act, 15 U.S.C. §2802, termination of a franchise may take place for failure to comply with a reasonable and material aspect of the franchise relationship. It should be made clear that taking advantage of the open supply provisions of S.326 does not constitute a ground for termination under the P.M.P.A. Otherwise, the important and necessary guarantee of open supply will be unavailable to those it is intended to protect.

My statement concludes with a description of the inadequacy of other laws, particularly the antitrust laws, as remedies for the ills addressed by S. 326. Those comments are based on my experience in over 100 antitrust cases and many more potential cases which were never filed because the potential plaintiff had neither the resources nor the staying power to even consider filing the case. Many of them were gasoline retailer cases. It is a difficult thing to tell individuals who have always considered themselves self-reliant individual entrepreneurs that they are really little more than economic serfs without the resources even to take advantage of rights they theoretically have guaranteed them by law. But that is the reality facing most retailers today and it is a cruel joke and a hoax to claim existing law adequately addresses the problems of retailers.

S. 326, particularly the divorcement and open supply provisions of the bill, are needed to rectify this situation and to establish free and fair competition in the retailing of petroleum products. Without it, we will see the continued decline of independent retailers in the market, continued chaos in marketing and an acceleration of the trend toward ever higher prices, less service and the demise of competition in gasoline marketing.

Petroleum Market Shares

A Monthly Report

March 1981

DOE/EIA-0066(81/03)

Report on Retail Sales of Gasoline

Prepared by; Harold R. Millie
Office of Oil and Gas Statistics
Energy Information Administration
U.S. Department of Energy

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Energy Information Administration

Washington, DC 20461

INTRODUCTION

This report monitors changes in the aggregate market shares of motor gasoline retailers. At the time the Emergency Petroleum Allocation Act of 1973, requiring the Department of Energy (DOE) to publish these reports, was passed, concern was expressed in Congress that during periods of product shortages, the large integrated refiner/marketers would favor their own retail outlets to the detriment of the competitive structure of the retail petroleum market. Therefore, DOE was instructed to monitor the market shares of the various types of retail petroleum marketers to insure the refiner owned and operated retail outlets did not become dominant. This publication circulates to selected members of Congress who are interested in and responsible for energy related areas. The publication also circulates to members of the DOE who are interested in the subject of petroleum marketing and organizations and individuals who purchase subscriptions through the Government Printing Office.

The independent marketer data used is based on a continuing survey of gasoline service stations. This survey is conducted by the Bureau of the Census as collecting agent for the DOE. The survey obtains data on the number of gallons sold by approximately 10,000 sample retail outlets each month. Market shares derived from this survey are based on data describing establishments primarily involved in the retail sale of motor gasoline and do not reflect direct sales to end users through other channels. About two-thirds of all gasoline sold to end users in the United States is sold by these establishments.

The aggregate sales figures for the category "refiner-marketers" were taken directly from a refiners survey conducted by DOE's Energy Information Administration (EIA) rather than from the Census Bureau sample survey. These two sources of information are used to develop estimates of market shares as required by section 4(c)(2)(A) of the Emergency Petroleum Allocation Act for nonbranded independent marketers and branded independent marketers (see definitions).

This section also requires data describing the marketing practices of "other" persons engaged in the marketing or distribution of refined petroleum products. These data are derived from the survey of known refiners, which is conducted by DOE.

It should be noted that since the majority of the estimates summarized in this report are derived from a sample survey rather than a census, they are subject to sampling error. The magnitude of the error for selected statistics, as reflected by the coefficient of variation, is indicated in Table 7.

Refinements and revisions of the data published in this series of reports occur from time to time as the result of improvements in estimation and data collection procedures. Two major revisions have been published to date. For more details on the revisions, see the June 1977 issue and the September 1977 through January 1978 issue of this report series.

This publication has been prepared by the EIA Assistant Administrator's Office of Energy Data Operations, Office of Oil and Gas Statistics, Division of Petroleum Marketing and Pricing Statistics.

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SURVEY DESIGN

The independent marketer data for this report were obtained from completed questionnaires returned from a sample of gasoline station operators. In a typical month, approximately 1,000 operators of nearly 10,000 nationwide gasoline service stations are included in the sample. These respondents are a part of the existing sample of retailers canvassed regularly by the Bureau of Census in its monthly retail trade survey.

ADDITIONAL MARKET SHARES INFORMATION

The U.S. Department of Energy is currently conducting several surveys of refiners and retailers of certain refined petroleum products. The surveys are designed to help monitor changes in marketing patterns and aggregate market shares relative to the base year 1972. For this purpose, sales data are collected for each month beginning January 1972 covering, at the refiner level: kerosene, No. 2 distillate fuel oil, jet fuel, residual fuel, propane, aviation gasoline and motor gasoline. At the retail level, gallonage sales data are obtained from marketers for: distillate fuel oil, propane, and residual fuel oil. Surveys covering the above marketers and products have continued on a monthly sample basis. A sample copy of a monthly market shares report entitled, Petroleum Market Shares - Report on Sales of Refined Petroleum Products is available through the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

FINDINGS

The U.S.[1] average retail price of motor gasoline for March 1981 was 134.3 cents per gallon. This price reflects a 14-percent increase over the price for March 1980. These preliminary numbers indicate that all brands increased in price (Table 4).

Branded independent marketers continued to dominate the retail gasoline market, accounting for approximately 69 percent of the gasoline sold. The nonbranded independents' market share of the retail gasoline market remained at 11.5 percent (Table 1).

Sales, considered together with the number of retail outlets, allows a more complete characterization of the gasoline market. Figure 2 illustrates the relative number of outlets by marketing category over time, while Table 6 gives the corresponding data by marketing category.

---

[1] See definitions.

Table 1. U.S. Market Shares of Gasoline Service Stations
(Percent of Total Gallonage Sales)

Year	Refiner-Marketers	Nonbranded Independents	Branded Independents
1975 Average	14.8	10.2	75.0
1976 Average	16.9	10.9	72.1
1977 Average	17.2	11.8	71.0
1978 Average	18.0	11.8	70.2
1979			
January	19.0	11.3	69.7
February	18.4	11.9	69.7
March	19.1	10.8	70.1
April	18.8	11.4	69.8
May	18.7	11.2	70.1
June	18.3	11.3	70.4
July	18.8	11.8	69.4
August	19.0	11.0	70.0
September	18.8	11.6	69.6
October	19.3	11.5	69.2
November	18.4	12.2	69.4
December	19.0	11.5	69.5
Average	18.8	11.5	69.7
1980			
January	18.6	11.7	69.7
February	18.8	12.4	68.8
March	19.5	11.3	69.2
April	19.2	11.9	68.9
May	19.0	12.9	68.1
June	18.7	12.7	68.6
July	18.7	12.5	68.8
August	19.4	12.4	68.2
September	19.7	11.8	68.5
October	19.5	12.0	68.5
November	19.3	12.4	68.3
December	19.6	10.7	69.7
Average	19.2	12.1	68.8
1981			
January	19.0	11.2	69.8
February	R19.2	11.5	R69.3
March[a]	19.8	11.5	68.7

[a] Preliminary data.

R=Revised data.

Note: Percentages may not add to 100, due to independent rounding.

Sources: Refiner-Marketers, U.S. Department of Energy Form P306; Nonbranded Independent Marketers and Branded Independent Marketers, Bureau of Census Forms SG-1, 2, and 4.

Table 2. Gallonage Sales through Service Stations by Marketer Type
(Millions of Gallons Sold by Retail Outlets per Day)

Year	U.S.[a] Average	Refiner-Marketers	Nonbranded Independents	Branded Independents
1975 Average	209	31	21	157
1976 Average	213	36	23	154
1977 Average	227	39	27	161
1978 Average	225	41	26	158
1979				
January	201	38	23	140
February	211	39	25	147
March	204	39	22	143
April	207	39	24	144
May	205	38	23	144
June	211	39	24	148
July	198	37	23	137
August	207	39	23	145
September	188	35	22	131
October	200	39	23	138
November	195	36	24	136
December	188	36	22	131
Average	201	38	23	140
1980				
January	178	33	21	124
February	186	35	23	128
March	182	36	20	126
April	190	37	23	131
May	190	36	24	129
June	193	36	25	133
July	197	37	25	136
August	200	38	26	136
September	191	38	23	131
October	190	37	23	130
November	190	37	24	130
December	194	38	21	135
Average	190	37	23	131
1981				
January	185	35	21	129
February	R188	36	22	R131
March[b]	184	36	21	126

[a] Data may not sum to averages due to independent rounding. These volumes represent approximately two-thirds of the actual volume sold to end-users.

[b] Preliminary data.

R=Revised data.

Note: Refer to Table 7 for a description of the coefficient of variation.

Sources: Refiner-Marketers, U.S. Department of Energy Form P306; Nonbranded Independent Marketers and Branded Independent Marketers, Bureau of Census Forms, SG-1, 2, and 4.

Table 3. Market Share by Brand Category
(Percent of Total Gallonage Sales)

	Refiner-Marketers		Independent Marketers		
Year	Majors[a]	Other Refiner Brands	Majors[a]	Other Refiner Brands	Non-Branded
1977 Average	7.1	10.1	59.6	11.4	11.8
1978 Average	7.6	10.5	58.5	11.7	11.8
1979					
January	8.2	10.8	59.0	10.7	11.3
February	7.9	10.5	59.0	10.7	11.9
March	8.0	11.1	59.1	11.0	10.8
April	7.6	11.2	58.2	11.6	11.4
May	7.8	10.9	58.8	11.4	11.2
June	7.3	11.0	59.7	10.7	11.3
July	7.8	11.0	58.1	11.3	11.8
August	8.3	10.7	58.3	11.7	11.0
September	8.0	10.8	57.8	11.8	11.6
October	8.0	11.3	57.5	11.7	11.5
November	7.9	10.5	57.4	12.0	12.2
December	7.8	11.2	58.2	11.3	11.5
Average	7.9	10.9	58.4	11.3	11.5
1980					
January	7.8	10.8	57.7	12.0	11.7
February	7.7	11.1	57.2	11.6	12.4
March	7.7	11.8	56.9	12.3	11.3
April	7.7	11.6	57.0	11.9	11.9
May	7.6	11.5	56.9	11.2	12.9
June	7.5	11.1	57.5	11.1	12.7
July	7.6	11.1	57.1	11.7	12.5
August	7.6	11.4	56.3	11.6	13.0
September	7.6	12.1	57.2	11.3	11.8
October	7.6	11.9	56.4	12.1	12.0
November	7.6	11.6	56.2	12.2	12.4
December	7.8	11.7	57.9	11.8	10.7
Average	7.7	11.5	57.1	11.7	12.1
1981					
January	7.5	11.5	57.5	12.3	11.2
February	7.7	R11.5	R57.1	R12.2	11.5
March[b]	7.9	11.9	56.7	12.0	11.5

[a] Primary and secondary brand names belonging to the following 15 major refiners: Amoco, Atlantic Richfield, Chevron, Cities Service, Conoco, Exxon, Getty, Gulf, Marathon, Mobil, Phillips, Shell, Sun, Texaco, and Union of California.

[b] Preliminary data.

R=Revised data.

Note: Percentages may not sum to 100 percent or equal those in Table 1 due to independent rounding.

Sources: Refiner-Marketers, U.S. Department of Energy Form P306; Nonbranded Independent Marketers and Branded Independent Marketers, Bureau of Census Forms, SG-1, 2, and 4.

Table 4. Average Price[a] by Brand Category
(Cents per Gallon Including Taxes)

	Refiner-Marketers		Independent Marketers			
Year	Majors[b]	Other Refiner Brands	Majors[b]	Other Refiner Brands	Non-Branded	U.S. Average
1977 Average	59.4	58.6	62.2	59.8	58.4	60.9
1978 Average	61.7	60.8	64.5	62.6	60.7	63.2
1979						
January	65.9	65.8	68.3	66.8	65.7	67.4
February	67.3	66.9	69.3	68.0	66.7	68.4
March	70.4	70.5	71.6	71.0	68.9	71.0
April	71.7	71.9	75.5	74.1	74.2	74.5
May	79.2	80.0	79.7	78.4	79.5	79.6
June	83.7	84.0	84.5	82.5	84.3	84.1
July	88.8	89.6	89.2	87.9	90.3	89.1
August	92.5	93.3	93.3	92.1	93.2	93.0
September	94.5	94.5	96.6	95.1	97.4	96.1
October	97.1	97.4	98.7	97.1	98.8	98.2
November	98.6	98.8	100.9	99.1	99.1	100.1
December	101.7	102.1	103.8	102.5	103.1	103.2
Average	84.3	84.6	86.0	84.6	85.1	85.4
1980						
January	107.8	108.7	109.3	107.5	108.5	108.8
February	114.6	113.0	115.2	112.1	113.8	114.4
March	119.4	116.2	119.3	116.4	117.5	118.3
April	120.4	116.9	121.5	118.7	119.0	120.4
May	121.7	118.4	123.2	120.5	119.2	121.8
June	122.1	119.1	124.6	122.1	120.8	122.9
July	121.6	118.9	124.3	122.0	119.6	122.6
August	120.9	118.3	123.7	121.3	118.8	122.0
September	119.6	116.8	122.6	120.0	118.6	120.9
October	119.1	116.0	122.1	119.7	117.9	120.4
November	119.1	115.9	122.5	119.4	117.1	120.4
December	120.7	117.9	123.2	120.0	119.1	121.4
Average	118.9	116.3	121.0	118.3	117.5	118.4
1981						
January	124.4	121.1	126.8	123.6	123.2	125.2
February	R131.8	R126.8	R132.8	R129.4	R129.9	R131.3
March[c]	135.2	132.0	135.5	132.1	132.6	134.3

[a] Weighted average price includes all grades of gasoline and types of service (full and self). Refiner-marketers' prices include an estimated weighted average tax and the independent marketers include reported taxes.

[b] Primary and secondary brand names belonging to the following 15 major refiners: Amoco, Atlantic Richfield, Chevron, Cities Service, Conoco, Exxon, Getty, Gulf, Marathon, Mobil, Phillips, Shell, Sun, Texaco, and Union of California.

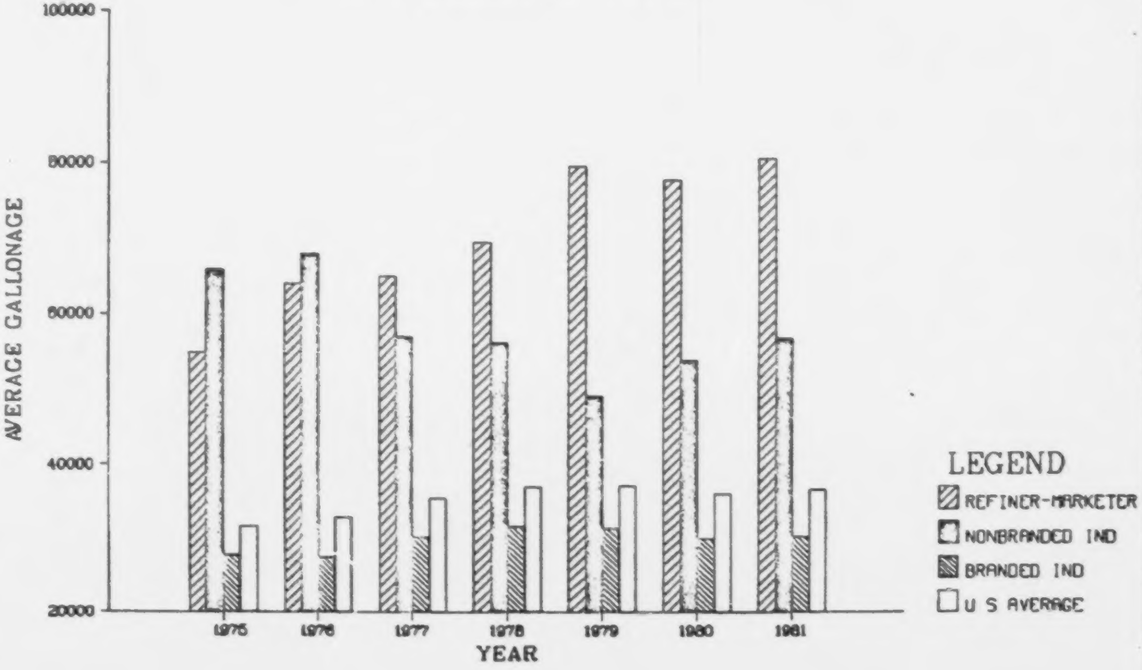
[c] Preliminary data.

R=Revised data.

Sources: Refiner-Marketers, U.S. Department of Energy Form P302; Nonbranded Independent Marketers and Branded Independent Marketers, Bureau of Census Forms, SG-1, 2, and 4.

Figure 1.

AVERAGE SALES BY RETAIL OUTLET
BY MARKETER TYPE



Data shown are for the month of January in the years indicated.

Table 5. Average Monthly[a] Sales of Retail Outlets[b] by Marketer Type (Gallons per Station)

	U.S. Average	Refiner-Marketers	Nonbranded Independent	Branded Independent
Jan. 1975	31,751	54,731	65,744	27,803
Jan. 1976	32,907	63,898	67,692	27,535
Jan. 1977	35,439	64,713	56,744	30,164
Jan. 1978	37,081	69,165	56,000	31,672
Jan. 1979	37,200	79,250	48,951	31,427
Jan. 1980	36,085	77,308	53,750	30,125
Jan. 1981	36,734	80,231	56,612	30,365
July 1975	35,943	59,606	60,186	32,030
July 1976	37,614	66,392	62,660	32,610
July 1977	40,653	76,048	64,496	34,715
July 1978	40,246	83,227	55,624	34,033
July 1979	37,596	80,595	60,756	31,087
July 1980	38,433	84,173	52,827	32,093

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[a] January data are not comparable to July data because of seasonal variations.

[b] The average sales per retail outlet shown here will not agree with data published prior to the September 1977 through January 1978 issue of this series of reports. Explanation of changes may be found in that publication.

Sources: Refiner-Marketers, U.S. Department of Energy Form P306; Nonbranded Independent Marketers and Branded Independent Marketers, Bureau of Census Forms, SG-1, 2, and 4.

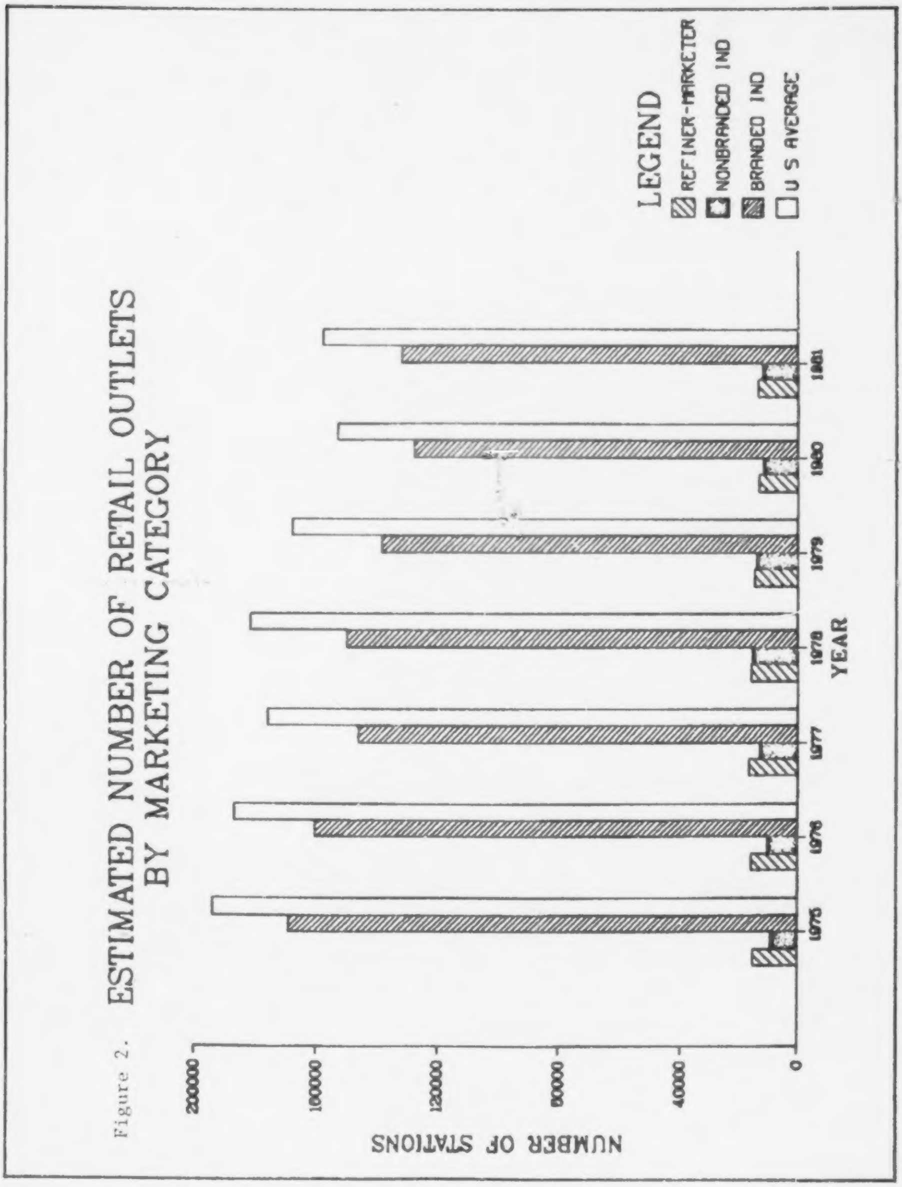

Figure 2. ESTIMATED NUMBER OF RETAIL OUTLETS BY MARKETING CATEGORY

Data shown are for the month of January in the years indicated.

Table 6. Estimated Number[a] of Retail Outlets by Marketing[b] Category

	U.S. Total	Refiner-Marketers	Nonbranded Independent	Branded Independent
Jan. 1975	193,410	15,110	9,400	168,900
Jan. 1976	186,341	16,041	10,400	159,900
Jan. 1977	175,228	16,828	12,900	145,500
Jan. 1978	181,063	16,063	15,500	149,500
Jan. 1979	167,249	14,949	14,300	138,000
Jan. 1980	152,678	13,278	12,000	127,400
Jan. 1981	157,490	13,590	12,400	131,500
July 1975	190,272	16,072	10,700	163,500
July 1976	182,191	17,291	10,900	154,000
July 1977	178,558	16,358	12,900	149,300
July 1978	177,832	15,632	15,600	146,600
July 1979	163,228	14,328	11,900	137,000
July 1980	158,983	13,583	14,500	130,900

[a] These estimates count only those retail outlets that derive at least 50 percent of their gross revenues from the sale of gasoline. As a result, they may differ from station counts published from other sources.

[b] The station counts shown here will not agree with data published prior to the September 1977 through January 1978 issue of this series of reports. Explanation of changes may be found in that publication.

Sources: Refiner-Marketers, U.S. Department of Energy Form P306; Nonbranded Independent Marketers and Branded Independent Marketers, Bureau of the Census Forms SG-1, 2, and 4.

Table 7. Coefficient of Variation for Selected March 1981[a] Estimates

	Volume	Month-to-Month[b] Change in Volumes
U.S. Total	3.8	0.7
I. Branded Independent		
A. Major Brands	3.8	1.2
B. Other Refiner Brands	8.6	1.0
II. Nonbranded Independent	29.6	2.1

[a] Preliminary data are used for March.

[b] The coefficients of variation provided describe the change between February 1981 and March 1981.

Note: The coefficient of variation is the standard error of the estimated mean expressed as a percentage of the estimated mean.

The particular sample selected for this survey is one of a large number of possible samples of the universe that could have been selected. Each sample would yield a somewhat different set of results. The sampling errors between the estimates obtained and the results theoretically obtainable for the complete universe are unknown. Guides to the potential size of the sampling errors, however, are provided by the Coefficients of Variation (C.V.) presented in Table 7. This provides a measure of the error relative to the size of the estimate.

DEFINITIONS

U.S.

This term represents the 50 States and the District of Columbia.

Categories of Marketers

1. Branded Independent Marketer is a company that markets and distributes refined petroleum products pursuant to:

   a. An agreement or contract with a refiner (or a firm that controls, is controlled by, or is under common control with such refiner) to use a trademark, trade name, service mark, or other identifying symbol or name owned by such refiner (or any such firm), or

   b. An agreement or contract under which any such firm engaged in the marketing or distribution of refined petroleum products is granted authority to occupy premises owned, leased or in any way controlled by a refiner (or firm which controls, is controlled by, or is under common control with such refiner), but which is not affiliated with, controlled by, or under common control with any refiner (other than by means of a supply contract, or an agreement or contract described in paragraph (1) or (2) of this definition), and which does not control such refiner.

2. Nonbranded Independent Marketer is a company engaged in the marketing or distribution of refined petroleum products, but which is not: (1) a refiner; (2) a company that controls, is controlled by, is under common control with, or is affiliated with a refiner (other than by means of a supply contract); or (3) a branded independent marketer.

3. Refiner-Marketer is a company that owns, operates, markets or controls the operations of one or more refineries and markets gasoline through retail outlets.

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PREPARED STATEMENT OF ROBERT S. CAMPBELL, JR.

Mr. Chairman and Members of the Committee:

My name is Robert S. Campbell, Jr. I am a lawyer engaged in the practice of law in Salt Lake City, Utah. My practice, now entering its 24th year, has been principally devoted to the trial of complex economic litigation, a substantial portion of which has been in the field of antitrust enforcement. I have attached to this testimony a Vitae which hopefully will be of some assistance in evaluating my statement to the Committee.

The reason for my appearance today is to address the factors of competition and antitrust policy that are before the Committee in S. 326. I have had occasion to address the subject of divorcement or divestiture at the retail market of the petroleum industry both as an academic and as a practitioner. In 1979, I spent some 8 months in a position with the Faculty of Law at Oxford University, England, in which I had occasion to research and write, as well as lecture, in the field of U.S. antitrust enforcement as it relates to the petroleum industry. The Thesis[1] which I completed at Oxford addressed squarely the competitive impact of requiring the large integrated major oil companies to divest themselves of retail gasoline stations. It has been published in the U.S. and in Europe. counsel or representative of any company, association, or organization who has a proprietary interest in S. 326. I have represented several oil and gas companies, both large and small, in the past and have also acted as counsel for small gasoline retailers as well as having engaged in the trial of cases involving antitrust questions in opposition to major oil companies. It was during the academic sabbatical at Oxford that I formed my basic view on competition policy in the petroleum industry which is before this Committee in its examination of S. 326.

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[1] "Antitrust Divestiture and Ancillary Restraints in the Petroleum Industry --- A Comparative Analysis of United States and United Kingdom Antitrust Law", Campbell, Robert S., Jr.. Bodleian Law Library Press (May 1980)

There are three particular areas of S. 326 as to which I would focus the Committee's attention. The first is Section 2 (a)(1) which would make it illegal for every refiner of crude oil to operate a gasoline service station in this Country with the exceptions that a refiner who purchased more than 70% of its crude oil supplies from independent sources in calendar year 1978 and one whose refining capacity does not exceed 175,000 barrels per day are exempted. The second is Section 2(b)(1), et seq., which would make it unlawful for any oil refiner to sell to any independent wholesale purchaser, including an intra-corporate transaction between the refining and retailing divisions of a company, any motor fuel for a price other than the daily wholesale transfer price as defined in the Bill, unless the price is cost justified or meets competition. The third is Section 2(c)(1), et seq., which would declare unlawful any interference with or restraint upon a dealer in purchasing, storing or selling gasoline except for an exclusive dealing arrangement in which the dealer may purchase gasoline from any other person on more favorable terms than from the contractual supplier.

Competition Policy of the United States.

This Country has long been committed to the proposition that competition between merchants as established by an open market is the fundamental assurance of economic and social progress. All traders, large and small, stand on or should have equal footing in the competitive market. In the best and legal setting, no one merchant or group of merchants should be preferred over other competitors. Through the process and interaction of competition, there should be achieved efficiency, economies of scale, invention, a fair return upon capital and, not the least, high quality products at the lowest, reasonable price to the consumer.

To verify that the market operates with fairness and free from unreasonable restraints of trade, the statute books have inscribed the antitrust laws. For almost 100 years, the Sherman Act has banned agreements and arrangements between two or more parties which unreasonably restrain trade as well as conduct, although unilateral, which restrains and monopolizes trade.[2] The Clayton Act has long forbidden unjustified discriminatory pricing, tie-ins and exclusivity supply contracts which substantially lessen competition or tend to create a monopoly.[3] Together with Section 5 of the Federal Trade Commission Act,[4] these Statutes require that competition in the market take place upon the merits and without favor or tribute to the large or the powerful. Criminal penalties, treble damages, payment of attorney's fees and costs, and injunctive relief await those who violate the U. S. antitrust laws. As Chief Justice Hughes stated in *Appalachian Coal*,[5] the antitrust laws are the American economic Magna Carta.

The Divorcement Provisions of Section 2(a)(1).

This brief introduction of the competition law and policy of this Country highlights the principal flaw of S. 326 --- namely, its anticompetitive character. Divorcement of crude oil refiners from the retail gasoline market would constitute a carve-up of the petroleum industry in arbitrary and economically unjustified parts. Rather than stimulate competition, divorcement will diminish it to the damage and expense of the consumer. Entry to the retail market will require vertical and axiomatic separation of the related functions in the petroleum business, unless one qualifies as an independent or small refiner. The economies of scale achieved through integration will be lost on those companies that fall under the Bill. The retail gasoline market will not be open to competition, but rather closed to a selected group who have been chosen not because they are successful competitors, but because they are not too large or because they have purchased crude oil from others at a particular moment in time.

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[2] 15 U.S.C. § 1, 2.

[3] 15 U.S.C. §§ 12-27.

[4] Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 46 speaks out against "unfair" methods of competition and "deceptive" business practices.

[5] *Appalachian Coal Co. v. U.S.*, 288 U.S. 344, 359 (1932).

The occasion has been rare in this Country when significant parts of an entire industry have been legislatively dismembered and then only when there has been clearly manifested a public need. The thrust of divorcement under S. 326 is at war with the plainly enunciated and firmly established principle of the antitrust laws. While divestiture of certain properties or assets of a corporation may be required in a given case to arrest the impact of a monopoly in the market, such is a remedial mechanism employed in an attempt to restore competition. Even at that, divestiture is recognized as an extraordinary tool of antitrust enforcement used only in a case-by-case analysis of aggravated anticompetitive behavior. S. 326, while adopting the threshold theory of divestiture, proceeds by divorcement to force it on a grand scale regardless of the competitive behavior of those, who by reason of sheer size and integration, fall under the Bill.

The Sweep of the Divorcement.

According to the calculation of the Department of Energy,[6/] there are at least 16 integrated oil companies who would be reached by the Bill. Those 16 companies, as of 1979, had an interest in better than 173,000 retail gasoline stations in various geographic markets throughout the Country.[7/] That number of stations although owned in differing and varying

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[6/] U. S. Department of Energy, Energy Data Reports, Petroleum Refineries Annual (January 1979) pp. 88-89.

[7/] 1979 National Petroleum News Fact Book Issue, pp. 52-57.

interests, comprise the great bulk of retail gasoline outlets in the United States. There has been, in recent years particularly, a reasonable level of competition in the retail sale of gasoline, the spectrum of competitors being independent marketers, lessee-dealers, and independent and integrated oil refiners. Rather than concerning itself with the nature and degree of competition in the various retail markets, however, the Bill is aimed at the size of the integrated oil company regardless of good faith competitive efforts.

Only that refining company who depended upon others for more than 70% of crude oil supplies in 1978 or that refiner whose capacity does not exceed 175,000 barrels per day is exempted from the divorcement provisions of S. 326. There does not on the face of it appear to be any economic or legal basis to conclude that a refining company who purchased 69% of its crude supplies from others in 1978 should be forced to withdraw from the retail gasoline market while that refiner who happened to have purchased 71% of crude oil supplies from others in the same year is authorized to remain in the retail business. As well, there does not appear to be any logical synthesis under the Bill to demand that refining company A, having a capacity (some unused) of 180,000 barrels per day be driven out of the business of gasoline retailing while refining company B, having used capacity of 175,000 barrels per day, should be authorized to remain and engage in the retail business. In point of fact, the definition of "small refiner" under the Bill would leave in the retail gasoline business a number of major integrated companies whose annual sales exceed a billion dollars and who possess market power.

The definitions of "independent refiner" and "small refiner" under S. 326 carry an arbitrary and harsh connotation. There is no apparent empirical evidence to demonstrate the fact that retail gasoline businesses, in the various geographic markets throughout the United States, would receive an upgraded level of competition with independent and small refiners being allowed to operate gasoline stations measured against that level of competition which now exists with all refining companies being entitled to engage in the retail business. Moreover, there is no graphic evidence that the large integrated oil companies, vis-a-vis the small refiner or independent refiner as defined in the Bill, have engaged in predatory pricing, boycotted independent retailers, or monopolized the retail business. Yet the divorcement section of S. 326 pushes the integrated major company out of the retail gasoline business and leaves the small and independent refiners in the retail business.

Without some better differentiation between the small or independent refiners from other refiners, the Bill would practice pervasive discrimination as well as discourage competition.

The National Retail Gasoline Market.

The retail gasoline market, viewed either by itself or in the context of the larger petroleum industry, is substantially unconcentrated. In fact, it is the most atomized and unconcentrated economic tier of the petroleum industry. Entry barriers are relatively low with less capital requirement than at any other phase. Whereas in prior decades there was a clear line between a company retail outlet and the independent gasoline station, such is no longer the case. The independent retail marketer has obtained new market share and penetration in competition with the integrated major companies. The increased price of gasoline at the pump, brought on by the OPEC embargo of 1973 and the national energy shortage of the 1970's, caused a change in the principal approach to retail gasoline marketing. The no-frills, gas-only stations that once were the trademark of the independents, became the main stream of retail practices in the mid-1970's and the more traditional distinction between the independent retailer and the integrated oil station became blurred. But that was merely a function of changing marketing

TABLE I

MAJOR COMPANY GASOLINE MARKET SHARES FOR 1978 - 1970

Company	% 1978 Market Share	%1970 Market Share
Exxon	7.3	7.4
Texaco	6.7	8.1
Socal	4.8	5.0
Amoco	7.7	7.3
Shell-U.S.	7.7	7.9
Mobile	5.5	6.6
Gulf	5.8	7.1
Atlantic/Richfield	3.8	5.6
Top 4	29.4	30.7
Top 8	49.3	55.0

Source: National Petroleum News (June 1979), p. 118.

U.S. Senate Report on Investigation of Petroleum Industry, (1973), p. 22, Table II-7.

techniques in a competitive business. No one has exclusive rights to the no-frill retail outlet.

The lack of concentration in the national gasoline market is reflected in the market shares of the large integrated companies. In 1978, Amoco and Shell were the market leaders with only 7.7%, respectively, of gasoline sales. The top four integrated majors had a combined market share of only 29.4%. It took the top eight integrated majors to reach even 50% of the total market.[8/] Table I, as listed above, reflects that between 1978 and 1970, nearly every one of the leading eight integrated major oil companies lost market share in the retail gasoline sales in the face of increased competition from independent and smaller companies. Collectively the top eight

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[8/] National Petroleum News (June 1979) p. 118. Actually, the first eight majors had an aggregated market share of 49.3%.

major companies lost almost 6% in market shares betwen 1970-1978. Thus, S. 326 would require divorcement in a retail market that is free from the dominion or monopoly of any one competitor, and which has seen increased market penetration from smaller operators in recent years.

The Argument of Predatory Pricing.

It is urged by some as a basis for divorcement of the retail from the refining tiers of the petroleum industry that the integrated major refiners have engaged in predatory pricing to drive out the small, independent retailer. That argument is only valid if the integrated major, after cutting his price to a loss position in order to drive out the smaller competitor, is subsequently able to raise his price and pick up the exited market shares. Predatory pricing can only be justified if short-term losses caused by low prices can be recovered by the long-term gains of monopoly pricing. If the party who engages in pricing tactics to eliminate a competitor, finds that he is unable to control the market and raise prices because of the existence of still other competitors, the predatory pricing scheme will be self-defeating. There has not been manifested either nationally or in particular geographic markets, any plan or plot of one or more integrated major oil companies to eliminate the small, independent retailer by predatory pricing. There are simply too many competitors in any given retail market for predation to succeed.

Even were predatory pricing shown to exist, the federal antitrust laws now on the books are fully adequate and capable of dealing with the matter. In short, there is no incentive to engage in predatory pricing by the integrated oil major, given the unconcentrated condition of the retail gasoline business.

The Problem of Upstream Subsidization.

It has been claimed that the large integrated oil firms should be forced out of the retail gasoline market because they have utilized profits from production, refining and other upstream operations to subsidize a lower return at the retail tier in order to eliminate the smaller independent retailer. Such contention assumes an artificially low price set by the integrated major during the short-term and until the small independent is forced out of business and thus is merely another way of describing predatory pricing. While there is evidence to indicate that the integrated major is able to sell through its own station at a price several cents less than that of the independent, there is no demonstrated fact to indicate that such lower price is not cost justified. If the lower price of the integrated major is cost justified because of operational efficiency and new marketing techniques of self-service and "gas'n-go", the lower price is not artificial and the consuming public is the clear beneficiary in the form of lower cost gasoline.

If the integrated major oil company in fact utilizes its retail stations as a means of insuring an outlet for its refined gasoline and is able to earn a profit on its integrated operations, the lower prices charged at the retail level is a clear gain for the consumer. Such subsidization by upstream operations of the integrated major lacks antitrust significance and should be encouraged.

Divorcement and The Element of Efficiency.

There is no prevailing economic theory that forecloses any entity from engaging in business at more than one marketing level of an industry. Indeed, if the matter turns on fundamental competition philosophy, it should be presumed that an individual has the freedom to engage in different marketing levels of economic activity at the same time. It is generally acknowledged that an integrated company, which combines the functions of production of raw material, processing or refining, and ultimate retailing, may achieve substantial efficiency in lowering the unit costs of goods, the development of new and better product, and the ability to increase or reduce capacity in accordance with market demand. That efficiency is felt in the marketplace and by the consuming public in the form of better quality and lower priced goods and stronger competition.

If efficiency of operation is enhanced at one or more of the production, refining or retail marketing tiers through the reduction of marginal costs, vertical integration is not only an acceptable method of competition, but it should be a clear social gain and a desired objective of antitrust. There is reasonably sound evidence that in the petroleum industry, the integration of retail, refinery and production operations is conducive to the reduction of marginal costs. Generally, a refiner has heavy capital investment in plant and is under contractual commitments or intra-company obligations to take significant supplies of crude oil. Thus, it may be important to the refiner that he have a secured outlet for the retail sale of its refined gasoline. Elsewise, the refiner will be dependent upon the uncertainties and vagaries of an independent down-stream retailer wherein sales could be interrupted or impaired because of the internal financial problems of the retail operator, his withdrawal from the retail market, and the like. A refiner can neither logistically or economically store gasoline for extended periods of time. While the requirement in the petroleum industry for consistent movement and sale from production to retailing is not necessary unique in the national economy, it nonetheless is a fact that contributes to efficiency at all levels and markets of the petroleum business.

Divorcement under Section 2(a)(1) of S. 326 forces the integrated oil refiner out of the retail gasoline market and thus precludes him from the efficiencies gained through integrated operations. Loss of efficiency weakens the integrated refiner as a competitor and thus damages the competitive process not only at the retail level, but at the refining level as well. That factor, on its own, is enough to conclude that the divorcement provision of S. 326 is anticompetitive. Unless the combination of the retail and refining functions of the petroleum business cause or result in a monopoly at one or the other tiers, vertical integration generally lacks antitrust significance.[9]

If there is exclusionary conduct at the retail market by the integrated refiner resulting in power of monopoly proportions, vertical integration will have antitrust consequences. In such event, the Department of Justice is capable of dealing effectively with the monopolizing refiner. There is no empirical evidence, however, to indicate that any integrated refiner, who is caught by the divorcement provisions of S. 326, has monopoly power in the retail gasoline market, much the less that it has achieved such power through predatory or exclusionary conduct. But S. 326 treats the major independent refiner coming within the Bill as though it had been guilty of monopolization under the antitrust laws.

Potential Result of Divorcement.

While divorcement under S. 326 seeks to bestow the retail gasoline business upon the special class of small, independent marketers, there is no guaranty that such result will take place. If it does not, then the whole thrust of the Bill will have been defeated and in the process, numerous integrated companies will have been denied the liberty of competing in the retail gasoline business. Were we to assume, for the moment, the occurrence of divorcement under the Bill, independent and small refiners, along with other well capitalized interests, would be able to enter the retail market, construct new self-service or gas'n-go stations or purchase existing outlets of the integrated refiners that have been forced out of the market by the Bill.[10] With strongly financed interests in the retail business competing against the one-station marketer, it is reasonably foreseeable that there would shortly develop another dozen or so retail companies, some of which would be independent and small refiners, across the Nation operating within a new oligopoly pricing system at the retail level that would be at least if not more insensitive to the independent one-station dealer as S. 326 now suggests is present with the large integrated refiners.

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[9] U. S. v. Columbia Steel Co., 334 U.S. 495 (1948); U. S. v. Paramount Pictures, Inc., 334 U.S. 131 (1948).

The principal difference, in addition to losing the benefits of efficiency through lower-cost operations of the integrated refiners, is that the new major retail companies would require a higher profit and return on capital. That, in turn, would result in higher priced retail gasoline to the consuming public. Thus, the anticompetitive thrust of divorcement under S. 326 may force present competitors out of the retail market to be shortly replaced by other retail competitors who are likely to require higher profits and higher prices to the injury of the consumer.

Adequacy of Present Antitrust Laws.

The basic argument in favor of divorcement under S. 326 is that through such statutory regulation of the retail gasoline market, a new and improved level of competition among small, independent retailers will be achieved. Even apart from what I have already said with regard to the anticompetitive nature of the Bill, it is my judgment that the present scope of the Sherman Act and the Clayton Act fully expect the same level of healthy competition. If an integrated major refiner engages in predatory pricing or other exclusionary conduct resulting in monopolization, it will not only be guilty of a felony punishable under Section 2 of the Sherman Act, but it will also be liable for treble damages, attorney's fees and costs under Section 4 of the Clayton Act, and subject to an injunction restraining any further anticompetitive behavior under Section 15 of the Clayton Act. Moreover, the offending oil company would also face the prospects of a court decreed divestiture of its retail gasoline stations to arrest the illegal behavior.[11/] If two or more of the integrated major refiners combine or conspire to drive from any retail market a small, independent retailer, Section 1 of the Sherman Act and the provisions of the Clayton Act just mentioned will take the full measure of that felonious misconduct. In short, the federal antitrust laws now in force are fully capable of dealing with the problem that divorcement under S. 326 would attempt to reach.

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[10] Although Section 2(a)(2)(A) *et seq.*, provides that dealer-operated stations may not be sold by the major integrated refiner unless the dealer is offered a right of first refusal, such proviso is applicable only as to the first sale. Notwithstanding doubt as to the legal validity of the restraint on alienation of Section 2(a)(2), it is unlikely that well-capitalized interests would be prevented from penetrating and establishing substantial positions in the various geographic markets of the retail gasoline business.

Besides the fact that there already exist adequate laws for effective competition enforcement, there is a distinct and major advantage of the present U. S. antitrust laws over the divorcement provision of S. 326. The Sherman and Clayton Acts focus precisely on specified unlawful or illegal conduct on a case-by-case basis so that anticompetitive behavior of an integrated major refiner is framed, isolated, and remedied under the particular facts. The offending refiner or refiners are required to pay a stiff price for predatory pricing or other exclusionary conduct with regard to the small, independent retailer. But non-offending integrated refiners are not required to unfairly pay for the sins of others merely because of their size and source of crude oil supply. Non-offending major refiners would be entitled to remain in the retail gasoline market and to offer to the consumer the advantages that may stem from the efficiencies, intuitions and lower prices of vertical integration.

[11/] Standard Oil Co. of New Jersey v. U. S., 221 U.S. 1 (1911); U. S. v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1949); U. S. v. Grinnell Corp., 384 U.S. 563 (1966).

In my judgment, a genius of the U. S. antitrust laws is their ability to act on each case of anticompetitive misconduct in the market while leaving the healthy facets of that market as free and open as possible. Such is not the case with S. 326. The Bill's omnibus divorcement would blanket the entire refining and retail gasoline markets, without regard to the good faith competition of a major integrated refiner. The results would not only be arbitrary, inequitable and anticompetitive, but would be the antithesis of what has been the talisman of the federal antitrust laws.

Thus, where the Sherman and Clayton Acts make for an efficient, open and competitive market, S. 326 augers for inefficiency, and a closed and anticompetitive market.

The Daily Wholesale Transfer Price.

Under Section 2(b)(1) of the Bill, it is illegal for any remaining independent, small refiner or jobber to sell to any retailer for a price less than that price established by the first independent wholesale purchase for the particular day, unless the lower price is cost justified or is made to meet the equally low price of a competitor. An unlawful sale below the daily wholesale transfer price applies to transactions between the supplier and an affiliated or subsidiary interest. The apparent object of establishing this rigid, uniform price is to outlaw the practice allegedly taking place in the retail market that jobbers and refiners sell to the small independent retailer at a higher price than they transfer gasoline to internal, subsidiary, or related retail operations.

There are several reasons why the concept of the daily wholesale transfer price under Section 2(b)(1) would not be sound legal policy. To begin with, anticompetitive price discrimination has been prohibited by the Robinson-Patman Act[12] for thirty-five years. That Act forbids price discrimination only when an anticompetitive tendency and effect can be proved, subject to such defenses as meeting competition and cost justification. Suggestions that the Act prohibit price discrimination on a per se or across-the-board basis have been consistently rejected. Bill S. 326 would unconditionally outlaw short-term price changes, whether discriminatory or not without any of the Robinson-Patman Act's requirements of competitive impact. This would substitute as an arbitrary rule for the normal workings of the marketplace, although there is no evidence that such a dramatic change for the longstanding Robinson-Patman philosophy is necessary or desirable.

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[12] 15 U.S.C. § 13(a) (1976).

Secondly, the provision of the Bill which attempts to block the transfer or sale of gasoline from the supplier to its affiliated or related retail operation at a lesser price than to a third party, if effective,[13] would deprive the general public of the inventiveness and lower costs of an efficient market through vertical integration. Unless there is unlawful predation, a sale or transfer to another subsidiary or operating division would reflect the reduced marginal costs of an efficient market. The Bill would eliminate those efficiencies by attempting to rigidify price in intra-corporate transactions, regardless of whether predatory pricing or scienter to injure a competitor was ever present.

The Provisions of Open Supply and Exclusive Dealing.

The last aspect of the Bill which I address is Section 2 (c)(1). It declares (A) unlawful any restraint or interference of any type with the open supply of gasoline to a retail dealer with (B) the single exception being an exclusive dealing contract between the retailer and a refiner or jobber; in the latter case, the exclusivity agreement is lawful only in the event that the dealer at all times remains free to purchase gasoline from another or competing source at a better price or under more favorable conditions.

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[13] There is a real question under the Bill as to whether an intra-corporate transfer of retail gasoline from the refining division to a retail operation or subsidiary would come within Section 2(e) (7),(8) or (15), since in law, the corporation is only one "person".

As to the matter of open supply under subparagraph (A), the U. S. antitrust laws already effectively deal with unreasonable restraints which obstruct a retail marketer from securing a product of supply for resale. Section 3 of the Robinson-Patman Amendment to the Clayton Act forbids a sale of gasoline to a retailer which is conditioned upon his not dealing in a competitor's goods, if that agreement may substantially lessen competition or tend to create a monopoly. To extend that illegality to every restraint on supply to a gasoline dealer, regardless of reasonableness or good intentions, would result in a special and privileged class of buyers, which is unjustified.

The rights of the small, independent retailer of gasoline to strong competition on the merits should be vigorously enforced under the antitrust laws and other rules of the law merchant; but it is quite another thing to carve out a sanctuary for the gasoline retailer that provides a right and remedy that no other retailer in any other industry shares. Antitrust policy protects competition, not the individual competitor. The prohibition under the Bill against interference in the source of supply is so broad, if not ambiguous, that it would very likely obstruct, or at least chill, legitimate business intercourse between competing suppliers and the gasoline dealer.

With regard to the exclusive dealing exception under subparagraph (B), the Bill would foreclose the enforceability of exclusive supply contracts that often are to the benefit of both the dealer and the refiner or jobber. Exclusivity agreements in the petroleum industry can have definite pro-competitive bias that stimulate competition. On one hand, the dealer may be able to contract for a reliable source of gasoline supply and is able to undertake long-term financing and plans for operation; on the other hand, the supplier is able to contract for a dependable outlet for refined product, reduce expenses of operations and stabilize its business. In both instances, the consuming public may gain through the operation of a more efficient market in a dependable gasoline supply at lower costs.

While the Supreme Court, in Standard Stations[14/] found, on specific facts, that exclusive dealing contracts violated Section 3 of the Clayton Act because of the comparative substantiality of trade restrained in a particular retail market, exclusive dealing arrangements in the petroleum industry are generally enforceable. The Bill would make exclusive dealing contracts between a refiner and retailer illusory. There would be no mutuality of obligation under such an arrangement, for the dealer would be, under the Bill, entitled to ignore his agreement if he were to find a more favorable source of supply at any given moment.

Both the open supply provision and the open-ended exclusive dealing facet of the Bill are anticompetitive and an unjustified attempt to confer a special privilege upon the retail gasoline dealer.

CONCLUSION

S. 326 is radical surgery. It would place under blanket illegality and eliminate an entire segment of the petroleum industry from engaging in the retail gasoline business. There is substantial danger to the free market in such a Bill regardless of the industry, but that is particularly so with petroleum where an efficient retail market may likely result from vertical integration of refining and retailing functions. The trouble with S. 326 is that its impact on a particular company depends upon the coincidence of size, without regard to, and even in spite of, good faith competitive behavior of

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[14/] Standard Oil Co. of Cal. v. U. S., 337 U.S. 293 (1949).

the individual company. The arbitrariness of such a result cannot be ignored.

The elimination of the integrated major refiner from the retail market by divorcement will have a serious anticompetitive effect on the retail gasoline business and upon maintaining an efficient market. The cost to the consuming public from the proposed divorcement will, in all probability, be substantial as new participants in the retail business, without the benefits of integration, exact higher profits to reflect a return upon capital. The integrated major refiners must account for their conduct under the present antitrust laws. Those laws provide significant and fully adequate relief for a small retailer who has been abused or injured by predatory or exclusionary conduct of a particular company. To exclude large integrated refiners solely on the basis of size or their up-stream supply of crude oil would be economically and legally unjustified.

The provisions of the Bill relative to sales by refiners at a rigid price and the provisions of open supply and non-exclusive dealing are already the subject of comprehensive antitrust laws. S. 326 would establish a privileged and special class of retail gasoline dealers, uncharacteristic of the American economy.

It is for these reasons that I submit S. 326 should not be favorably reported by this Committee. I wish to thank you for the opportunity given to me to appear before the Committee.

Mr. CHUMBRIS. We will now call the next panel: Jack Houston, Robert Taylor, Tracy Stanton, Fred Allvine, and Paul Ashton.

Mr. Houston, will you lead off?

STATEMENT OF JACK W. HOUSTON, CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, SERVICE STATION DEALERS OF AMERICA, ATLANTA, GA., ACCOMPANIED BY JERRY S. COHEN, GENERAL COUNSEL

Mr. HOUSTON. Thank you, Mr. Chairman.

My name is Jack W. Houston. I am employed by the Georgia Association of Petroleum Retailers and have been so for 25 years. I am representing the retail dealers of that State.

I am chairman of the Government Affairs Committee for the Service Station Dealers of America.

Mr. Chairman, we hope the members of the committee will take notice of some of the content of the material which we will verbally cover at this point.

We would ask that the full statement submitted be inserted into the record as is. I have prepared some notes from the original copy and will take as little time as possible here in order to hit the highlights.

Mr. CHUMBRIS. Without objection, it is so ordered. Each of you will have that same privilege.

Mr. HOUSTON. I would like to start out by reading to you one paragraph of a letter from the President which was signed May 18, 1981. He said:

> It is difficult to think of life in America without thinking of the tens of thousands of service stations that dot our highways and play such an important role in the lives of our cities and towns, both economically and as a vital part of community life.

Unless anticompetitive marketing practices are corrected, consumers better prepare to do without most of the tens of thousands of service stations dealers who dot the highways.

Competition and retail dealers are being destroyed by marketing practices of refiners and their local wholesale jobbers.

S. 326, with the amendments we have offered in our full statement, will effectively and fairly stop anticompetitive marketing practices of refiners and jobbers. The bill will give dealers a fighting chance to prove that they are more efficient than supplier employee-operated retail stations.

The bill will not preserve the inefficient or poorly managed dealer operations. Public choice and patronage will decide who survives.

The amendments offered include preservation of jobbers' functional allowance and prohibition of jobber retailers and refiner retailers from earning less on sales made at retail outlets than would have been earned if the same product had been sold at wholesale to a dealer.

Government intrusion in the private sector is justifiable only if it produces benefits that outweigh the costs.

The benefits that accrue to consumers from competition among tens of thousands of dealer-operated local small businesses that retail motor fuel throughout America are by far greater than any benefits that could accrue, if there are any, from a comparative handful of impersonal corporations with employees who provide no services but only pump motor fuel or observe consumers pumping their own fuel.

Present laws, such as the Robinson-Patman Act, are neither applicable nor reachable to correct these anticompetitive marketing practices. The structural and behavioral changes that would be ordered with passage of S. 326, if amended as we have requested, will provide lowest prices and maximize the availability of essential services for consumers of motor fuel.

Since the January 28, 1981, decontrol order signed by the President, we have seen an increase in anticompetitive marketing behavioral patterns of jobbers. Many jobbers are increasing their direct sales to consumers through employee-operated retail outlets by selling at retail prices that are far below the wholesale prices they charge their own dealers with whom they compete.

This practice of jobbers and refiners has discredited competitors and has deceived consumers. The result is economic eviction of dealers and a future with less benefits for consumers from competition in motor fuel retailing.

Refiners poised and ready to pounce upon jobbers and any remaining dealers at some future date are waiting in the wings to see if Congress will step in to stop the economic slaughter of dealers and competition that has taken place in our industry.

There are some exceptions. For example, Texaco has about half completed its network of new self-serve centers strategically located around the city of Atlanta. Of the estimated 50 Texaco dealers in the proximity of the self-serve centers who are still in business today, most will not have a fighting chance when Texaco decides to drop its retail price low enough to drive them out of business.

There was a full-page advertisement a few days ago in the Atlanta newspapers to knock out the knock by buying from Texaco's new 20 outlets.

Some research which I am in the process of finalizing and which has been handed to me within the last 2 days I expect to submit for the record.

The full report of this shows that 14 of the 19 outlets are in fact controlled by the company—Texaco—in retail pricing and that many of these outlets are selling a fraction of a cent to several cents below the wholesale price the Texaco dealers in the city are paying. Those Texaco dealers are competing with strategically located stations.

An analysis will be presented to the committee in written form so that you will be able to see the locations of the stations around the cities.

They—Texaco—have set this up to control the market.

The divorcement of at least the largest refiners is important to the preservation of competition in small business opportunities and gasoline marketing.

I would like to point out that Atlanta is not just an isolated circumstance I have cited. It is just that I am personally acquainted with this and can speak with authority of what has happened.

There are many other cities around this country—many hundreds of them, I suppose, if we started counting them—that could report the same problem.

The largest refiners must not be permitted to take over the retail marketing of gasoline to the same degree that they have control over all other segments of the industry today.

Mr. Chairman, I submit to you that S. 326 should be passed with the amendments.

SSDA—the Service Station Dealers of America—stands ready to negotiate and work out a compromise. We do not stand on the exact language of the bill as being necessarily that hard and firm.

We say that the practical relief which we seek is what we are asking for. If there be different ways of accomplishing that objective, we will certainly support a different way to accomplish the effort to correct the unfair and abusive practice that is in the market today.

At this point, Mr. Chairman, I would like to give 3 minutes of time at least to each of the three gentlemen who are sitting with me as dealers.

Starting with South Carolina, Butch Taylor would like to present his testimony at this time.

STATEMENT OF ROBERT G. TAYLOR, EXXON DEALER, GREENVILLE, S.C.

Mr. **Taylor.** Mr. Chairman, I appreciate the opportunity to be here and to speak before this committee.

I appreciate the fact that my testimony will be submitted for the record in its entirety. It is not very long.

I would like to read certain highlights from it, if the committee will bear with me.

I have been connected with the service station industry since 1959 when I first went to work for a dealer. Since then, I have been a company employee at a company-operated training station, a commission operator, a jobber dealer, and since 1973 I have been an independent dealer.

I have seen the ins and outs, the ups and downs, the market changes, the price wars, the embargoes, the allocations, the gluts, and I am still here. Why? Only through the will of God who gives me the strength to want to survive in today's market and to remain as a viable economic business outlet where the consumer can still get legitimate, down to earth, plain sense, honest service.

I have been to our Nation's capital many, many times to plead the case for service station dealers about the many, many abuses that exist in the marketplace. These abuses did not occur yesterday or last year but are now culminating and are nearing volcanic stages.

I have read page after page after page of testimony given by dealers and expert witnesses about abuses perpetrated on the service station dealer by the major oil companies and jobbers.

The frustration of shallow promises to the dealers is nearing flood-tide proportions.

We want to believe that the Congress is willing to correct these abuses. We are sensible people. We want the best deal for the consumer. After all, the consumer represents our very living. You have to sell to do well.

The problem is that because of an historically high buying price, we cannot even sell well. As a matter of fact, we can hardly sell at all.

My question to the committee is this: Do you think we have a legitimate case in wanting to establish an equitable buying price? Do you think it is unfair to ask the Congress to stop the anticompetitive marketing practices of the oil companies and their local jobbers who compete directly in the market with their own dealers?

I have some personal financial information here, which is true. It is not untrue of a number of other dealers in the country.

I borrowed $10,000 in 1973 to open my present location. Road construction in 1973 to 1975 cut my volume by 50 percent.

I sat down and talked with my bank, explaining my problem with decreased volume and cash flow. They said not to worry and that they would hold my checks I had written for gasoline until I could deposit funds to cover said checks.

I do have a large amount of credit card sales which have to be mailed to my supplier in Houston, Tex. I receive a check in 5 to 7 days.

In 1975, I borrowed $2,500 from my bank to help offset this credit card float. I increased this note to $5,500 in 1976. I increased the same note in 1977 to $9,200.

I borrowed $7,700 from my life insurance policies in February 1978.

I renewed my $9,200 note in April of 1979. I renewed the $9,200 note in January of 1980. I renewed the $9,200 note in December of 1980.

On January 28, 1981, my bank returned my gasoline check to Exxon Co., for insufficient funds. At the time my $11,100 gas check was returned, I had a $7,700 bank balance and $11,100 in receivables in the form of credit cards.

I had gone to the bank president only the week before and talked to him face to face about this problem. He told me not to worry that he would hold my check.

However, 1 week later, he returned my check for gasoline to Exxon. Exxon Co., called me and informed me that I would now be on certified check requirements for 6 months. That means cash up front.

That same day I received one check for $4,400 which would have covered my deficit at the bank.

This problem is not particular just to me. Every dealer in the country has a similar problem.

We see a serious business volume loss to unfair competition on the street.

My own personal volume loss is around 30 percent. I have averaged historically 40,000 to 50,000 gallons monthly. I now average 30,000 gallons a month.

On February 1, 1981, I ceased buying direct from my supplier because I refused to second mortgage my home. My lease requires that when I buy from Exxon Co., I must buy full transport loads—a $12,000 expenditure at the time of decontrol.

Therefore, I called a local branded Exxon jobber who agreed to bring me what I could buy and pay for and not worry about writing a check on funds which were not available.

Gentlemen and committee members, that is how I have been operating my retail service station since February of this year.

I cannot continue on this precipitous course much longer with competition at 116.9 cents retail on the street when my cost is 123.0 cents.

Have the courage to give me the right to purchase gasoline at the same low price others can buy it for and stop suppliers from selling at retail below the price the suppliers charge dealers, plus the cost of operating the retail business.

Do this and you will give all consumers the assurance of lowest price with maximum value for their motor fuel dollars. That is the best deal for consumers, for it will preserve competition among tens of thousands of retailers and will make available to motorists essential gasoline-related services.

Thank you.

Mr. CHUMBRIS. Thank you, Mr. Taylor.

Mr. HOUSTON. Mr. Chairman, Tracy Stanton from Ohio would like to speak next.

STATEMENT OF TRACY L. STANTON, SHELL DEALER, BEXLEY, OHIO

Mr. STANTON. Mr. Chairman, my name is Tracy Stanton. I am independent branded gasoline dealer. I operate a service station in the State of Ohio. Currently I sell Shell gasoline and I am a Shell dealer.

I am here on behalf of all the independent service stations and all the independent dealers in the State of Ohio.

The independent branded service station dealer is being priced out of the gasoline market today—not by his particular oil company or not on a regional basis, as some previous testimony indicated, but by all oil companies collectively.

In today's market with what a consumer must pay for gasoline brand has become of less and less importance to the point where brand is of little importance.

It is not any one brand of oil company or any one region. It is the oil companies collectively that are pricing us out of business. It is price that is putting us out of business.

It is the so-called wholesale or dealer tank wagon price that I and other independent dealers must pay for gasoline which is putting us out of business—out of business at the rate of 34,000 service stations in the year 1980 alone.

To people like me, that is frightening.

I have listed in my testimony, so-called wholesale price independent branded dealers must pay for gasoline and compared that wholesale cost with the retail price that company-operated service stations are charging the consumer.

I will give a couple of quick examples here.

Using the dealer's tank wagon price—what the dealer must pay—and comparing that to what his oil company is selling it to the consumer for on the street:

Marathon is a big marketer in the State of Ohio. In Columbus, Ohio, where I took this survey on July 23 of this year, Marathon dealers were paying $1.236 per gallon of regular gasoline, since regular is traditionally used to market gasoline.

That is what a Marathon independent dealer paid—$1.236—bonded as a wholly owned subsidiary, gas-only Marathon operation.

It was selling on the street at $1.199—3.7 cents below the cost that their own branded dealers were paying for the same product.

I contend that we cannot compete in that kind of an atmosphere.

Another big marketer in Ohio is Sohio—Standard Oil of Ohio. Standard Oil has a different pricing structure. Their prices to their dealers in the State of Ohio—the wholesale price—runs between $1.207 and $1.257. I have averaged it out to $1.232. The average wholesale price that a Sohio dealer pays in our State is $1.232 for a gallon of regular.

The Sohio Co. operations are priced as low as $1.219. Here, again, they zone price. Whatever the competition will bear, they charge for gasoline. It is 1.3 cents below the dealer's average tank wagon cost.

We have a company in our State that markets under the name of Omega, which belongs to Standard of Indiana, who is supplied by Standard of Ohio. They market at 1.3 cents below the dealer's wholesale tank wagon cost.

I learned today that in Cincinnati we have company-operated gas onlies that are retailing gasoline for $1.159. That is tax included. The lowest dealer tank wagon I have on this list, and I understand some have gone down since I took this survey almost as much as a penny a gallon, is $1.2215.

I contend that we cannot compete in that market. We cannot compete in that atmosphere.

Many times a dealer will go to an oil company and ask for help—what can he do if he is not making any profit. The habitual oil company solution to a dealer in financial trouble is to lower the retail price. Do not worry about your profit.

If you have a full service service station, you move a lot of gallons of gas. They would like to sell 100,000 gallons of gas at every location, and I can understand that. You give your gasoline away. You make 5 or 6 cents a gallon on the so-called pool margin. You add all three of your grades together and whatever your average profit is, they call that a pool margin. You have nothing to say about the percent of return on investment.

Where you make your money is from the phenomenal increase in the traffic you get across your gas island and the repair work you do on this phenomenal increase in traffic.

What it boils down to is that you give your gasoline away on the one hand and break even or lose money and on the other hand you run a service department and you make it up.

I ask this committee and those who are interested: Is this a good business practice? Is it a viable business practice in any economy, whether it be today's or the economy of the thirties during the depression before my time. It makes no sense.

In today's market, we have independent dealers, such as myself, who have gasoline only operations. I have one. It is a Shell gasoline only operation.

I wanted this operation very badly when it became available. I wrote a letter to the management people requesting it. After nobody else would take it, I was allowed to lease it.

I will admit that under controls and in a controlled market, that the first 10 months I was in business in that location I made money.

With the advent of decontrol and the advent of the glut of product that we have on the market today, my volume started to go down. I have always tried to compete with the company operations. I tried to sell my regular at 3.6 above cost for my regular grade gasoline. I continued to lose money and continued to lose money in February, March, and April.

In May, after talking with my accountant and people who were concerned, I wrote a letter to Shell Oil Co. requesting termination of that least, because I was fearful that that business was going to be detrimental to my other business and I did not want one to support the other.

My last day at that gas-only location will be the 7th of August of this year.

I cannot compete when any oil company—not necessarily my own supplier——

Shell tells me they have only 50 company operations in the entire Nation. That puts me in a position that is unique to what this committee talks about.

My own supplier is not my competitor. What they charge me for gasoline I cannot compete because they are charging me 3.7 cents a gallon more than what the same product is being sold for on the street, no matter what the brand.

One other thing that I want to tell the committee that I overlooked. I have made a profit at my gas-only this year. I have made a net profit. I understand that is money you have left over after you pay all the bills. The net profit from January through June of this year at my gas-only operation is $1,732.

There is always another option that the independent dealer has to compete and stay in this noncompetitive controlled market. You can mark up your gasoline, your product, what you feel is necessary to make a reasonable profit on that product. Depending on your location in the country today, it is somewhere between 12 and 20 cents a gallon to run a full service facility and pay the people properly and run an operation with a good image.

If you do that and if you have the nerve to mark up your product and give the service that goes along with that high price, then you put yourself in the position that I am in in my full service location. You put yourself in a position where you only sell 40,000 to 50,000 gallons of gasoline a month to those people who want to pay that price for the service they get at a full service operation.

Then your parent oil company comes along and says: You need to be more competitive in the marketplace. How can you be competitive when they are selling 3.7 cents below your cost? You cannot be competitive. You cannot get close to it.

Getting close to $1.199 at $1.226, which is cost, does not sell gasoline.

When you sell gasoline at a reasonable profit, you put yourself in the position that you may not get your lease renewed because your location is no longer profitable to your parent oil company because you did not sell adequate gallonage to make it profitable for them to bring product to you.

You are working both ends against the middle.

There are many more problems that an independent dealer faces in today's market. However, if we as independent dealers are not allowed to shop for the best price for our product, if we are forced to continue to try to compete with our landlord and supplier and if the oil companies are allowed to continue their carefully planned monopoly of the petroleum industry, the independent branded service station is doomed.

At the 1980 rate of 34,000 stations out of business, in 3 years they are going to have it all.

People with the small financial clout, as the independent service station dealer, obviously cannot win a confrontation with companies—I want you folks to listen now to who filled the top 13 of the top 20 slots in the Forbes 500 rating for 1980.

Oil companies filled the top 13 slots of the top 20 of the Forbes 500 rating for 1980.

Forbes is a magazine that most of you know that rates companies' sales and profits, among other things.

We need three things to stay alive.

Oil companies which refine gasoline must be prohibited from retailing, simply because of the way they do it and simply because people like me cannot compete with that product.

It is not regional but national. These oil companies are national companies. They are multinational companies. It does not make any difference if it is Cleveland, Ohio, or Salt Lake City, Utah. It is a problem many times with the same company.

All wholesale gasoline purchasers must be able to buy like product in like quantities for a like price from a common source on any given day.

Any gasoline retailer must be allowed to buy the same quality product from any supplier who offers the best price.

We cannot obtain these means alone. That is why we are here today to talk to this committee and this Congress and to ask for your help.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Mr. HOUSTON. Mr. Chairman, if I may, we would like to have the gentleman from Utah, Paul Ashton, make about a 3-minute statement.

The CHAIRMAN. Mr. Ashton, we would be glad to hear from you.

STATEMENT OF PAUL F. ASHTON, CHEVRON DEALER, PROVO, UTAH

Mr. ASHTON. Thank you, Mr. Chairman.

My name is Paul Ashton. I am a lifetime resident of the State of Utah and reside in the community of Provo. I am the association dealer president of the Utah Petroleum Retailers Organization, which we call the PRO.

I operate as an independent petroleum dealer. I have two service stations in the Provo area—one is a branded Chevron and the other is a private branded station.

Like so many small businessmen across the country, I have everything I own invested with the many years I have put into these two stations.

In spite of the many problems I face in my profession, it is seldom that you will find people such as myself appearing in a forum such as this one today.

In fact, I believe that I may very well be the first Utah independent service station dealer to so appear. The reasons are really very simple. We are just that—independent.

Traditionally we have worked to resolve our own problems and challenges internally.

However, today I am here to review for you a concern that neither my peers nor I can resolve by ourselves. That problem is caused by our suppliers—the refiners moving forward into the retail gasoline marketplace.

I am aware that whenever this subject comes up, the refiners vehemently deny this charge. Nevertheless, in the State of Utah today, it is a fact of life.

For a few minutes I would like to review with you some of the marketplace facts in Utah today. Because of the time restrictions, I would present the facts regarding only one refiner, Amoco.

However, the problems in Utah are in no way limited to only Amoco.

In 1975, in the Salt Lake Valley alone, Amoco had 53 independently leased or independently owned branded Amoco locations. I have shown in exhibit 1 the phone book which lists those 53 dealer operated stations.

During the years following, Amoco embarked on a program designed to get rid of the dealers and reap brand for company operation.

The tactics used to displace these dealers were varied and brutal and very effective.

As you will note from exhibit 2, the 1980 Salt Lake phone book lists only 8 of those Amoco dealers left—8 out of 53.

Since that book was published, one more of the dealers has been eliminated.

Exhibit 2 also contains another page from the 1980 phone book which lists Rainbo stations—the gasoline pumpers operated by Amoco Oil Company.

In the late 1970's, as Amoco began to wrap up their "get rid of the dealers program," they began to place on-stream these company operations.

Exhibit 2 shows the 22 locations which have been introduced in the past few years. Of course, there have been changes since the phone book was published. Several more Rainbo stations have been introduced during the last year.

Mr. Chairman, I put before you the often heard plea of the gasoline refiners concerning an alleged drop in market share and how they must change their marketing operations to address this problem.

Consider in Utah, that Amoco forced the elimination of over 80 percent of its total Amoco-branded outlets. This elimination took place just prior to the placement of company-operated Rainbos back into the marketplace. Therefore, whatever market share

Amoco had had previously would have to be drastically affected prior to the placement on-stream of the company operations.

This smokescreen of surprised concern regarding loss of market share was created by Amoco itself through the displacement of its dealers.

Now with the dealers eliminated, Amoco is going to the next step to try to convince anyone who will listen that by making this change in retail operations, they are able to regain their lost market position.

I mentioned previously that the methods of dealer elimination in Utah were varied and brutal. I would like to document for you one of the most brutal methods that has been, and still is being, used in the marketplace today.

Exhibit 3 contains this evidence. The photograph was taken on July 27, 1981, just 3 days ago. It is the photo of a Rainbo station operating on the same main thoroughfare as one of the few remaining independent Amoco dealers—approximately 11 blocks away on the same street.

Note that the Amoco-operated Rainbo station is pricing retail at $1.249 for regular and $1.289 for unleaded gasoline.

On page 2 of exhibit 3, note that the independent Amoco dealer's purchase price before any consideration for the high rents and so on that he has to pay, in addition to the purchase price of the gasoline, is $1.247 for regular and $1.287 for unleaded.

In other words, this remaining independent dealer who is contractually bound to purchase his gasoline from Amoco, who is also his street competitor, must purchase his gas wholesale at prices only two-tenths of 1 cent lower than his supplier is retailing gasoline for down the street. That is not 2 cents but two-tenths of 1 cent.

The effect of this type of condition is very simple. The independent retailer faces two choices—both bleak. If he holds up his price to try to make enough profit even to cover his expenses, he is going to begin to lose his customer base. If he lowers his price enough to compete with his supplier/competitor, Amoco, he is grossing no profit, is working for nothing, and is not producing the profitability to remain in business.

In either case, the dealer reaches a point of financial exhaustion. He falls like a piece of ripe fruit from a tree. Amoco claims the location and either converts it to a Rainbo or sells the property, and then proudly proclaims that once more it has made another marketing stride to assist the motoring public while reclaiming its lost market share.

Mr. Chairman, I realize that there have been immensely time-consuming studies which claim that the refineries are not moving forward into the marketplace. I submit to you that the evidence I have shown you is in direct contrast to those claims.

This evidence which regards only Amoco represents only a portion of the evidence gathered in Utah alone which can be presented to this committee to document the forward movement into the Utah marketplace by several other refiners.

As a small independent petroleum retailer, I plead with you to assist us by creating legislation which will prevent these giant oil companies from placing independent petroleum retailers across this Nation in positions that are totally untenable—therefore eliminating the small businessman from the petroleum business in America.

Not only do I plead with you to do this but I believe that as our elected officials you have an obligation to do this.

I seek your help in this regard, and I thank you for affording me the opportunity to appear before you today.

Thank you.

Mr. HOUSTON. Mr. Chairman, we have one additional speaker to conclude our speakers and then we will be ready to answer questions.

The next speaker is Dr. Fred Allvine, professor of marketing, Georgia Institute of Technology.

The CHAIRMAN. We will be glad to hear from you.

STATEMENT OF FRED C. ALLVINE, PROFESSOR OF MARKETING, GEORGIA INSTITUTE OF TECHNOLOGY, ATLANTA, GA.

Mr. ALLVINE. Thank you, Mr. Chairman.

It is a pleasure to have an opportunity to appear before this committee again.

Just as a matter of brief review, my research in the petroleum industry dates back to 1968. I have appeared probably on three dozen occasions before committees of Congress and before this committee, looking at the problems.

There has been a great deal of rhetoric relative to what hopefully would be done. I hope that we are coming to the end of a long journey.

I think the evidence is very substantial that the industry is blanketed with a large number of anticompetitive practices.

What you have heard from these dealers could be repeated by hundreds of dealers across the country.

We have an industry that is not operating in any sense in a competitive fashion.

The proposal that is before you, I think, would redress many of the ills of this industry. It would enhance and improve the competitive process. In my judgment, it would result in more efficient utilization of lease sources and would be in the public interest.

I would just quickly give an overview of my written statement and would request that that be put into the record. It goes to the heart of an issue that has been discussed by some of the Senators here today.

The CHAIRMAN. Without objection, it will be placed in the record.

Mr. ALLVINE. Thank you, sir.

The issue before this committee is whether major brand dealers are subject to unfair and anticompetitive actions from their landlord suppliers and need new protection under the law.

In the past, I have had opportunities to study problems of independent refiners by brand marketers. In the more recent years, I have had the opportunity to examine conditions being experienced by branded dealers.

All of these downstream competitors are very vulnerable to anticompetitive actions of large integrated petroleum companies.

Since the mid-1970's many branded dealers have been subject to a variety of anticompetitive techniques designed to economically evict them from the stations in which they operate.

Congress, in passing the Petroleum Marketing Practices Act of 1978, mandated a study to be undertaken to examine the issue of economic eviction. The Office of Competition, Department of Energy, was assigned the responsibility for carrying out the subsidization study.

As you are aware, they came to the conclusion that the major petroleum companies were not subsidizing their marketing as part of a predatory campaign.

The study which Congress mandated and the Office of Competition promised to conduct was never carried out. Congress mandated that the study, among other things, was to "examine the profitability of various segments of the petroleum industry and to determine the extent to which such subsidization is predatory and presents a threat to competition."

The profitability of various segments was not studied as mandated by Congress and promised by the head of the Office of Competition.

Ignoring a great deal of readily available information about profitability of the various segments, a theoretical study was designed that defined away the problems of subsidization. This seriously flawed study was then used to conclude that dealers were not confronted with anticompetitive practices that resulted in their economic eviction.

Enclosed is chapter 5 of a monograph being prepared that deals with the anticompetitive nature of the operations of the large integrated petroleum companies. This chapter goes into detail, explaining major flaws in the DOE study.

Drawing upon publicly available information, evidence is presented supporting the conclusion that the major petroleum companies were in fact subsidizing their marketing as part of a predatory campaign.

Without some form of legislative protection from the anticompetitive behavior of their suppliers and landlords, thousands of additionally branded dealers will be unfairly driven out of business.

Thank you.

Mr. HOUSTON. Mr. Chairman, that concludes our statements.

We are prepared to respond to questions, except at this point I would like to ask that there be inserted into the record a copy of the statement from I-95 Shell which has been circulated.

It is from Mr. Cody from Brunswick, Ga., who has had firsthand experience in the pressures of a major oil company attempting to convince their dealers to oppose the passage of this legislation.

Mr. Cody is in the hearing room if the chairman or someone wishes to question him.

The CHAIRMAN. That completes the presentations of all of you?

Mr. HOUSTON. Yes, sir.

The CHAIRMAN. I have a few questions here.

Mr. Houston, you state that jobbers are growing because they have the advantage in the buying price. Why do refiners give them this price advantage?

Mr. HOUSTON. Jobbers perform a very valuable function in the distribution system, I believe. They deserve the opportunity to survive. They are entitled to some compensation for performing this service.

The CHAIRMAN. How is this bill ultimately going to affect the jobbers?

Mr. HOUSTON. The bill in its present language makes it possible for everyone to buy at the same price from the rack. We have proposed an amendment in our written statement submitted here today that would protect and preserve the jobbers' functional allowance, but also language that would say that that jobber could not utilize that advantage in buying price as a retailer, nor could any other refiner who was permitted to continue retailing. That is, they must earn as much in selling at retail as they earn in selling at wholesale.

The CHAIRMAN. As long as he is a jobber, he can buy——

Mr. HOUSTON. At an advantage in price.

The CHAIRMAN. If he operates a station himself, then he would be under the same competitive position with other retailers?

Mr. HOUSTON. Yes; he would if he were denied the right to utilize that advantage in buying price to be through used at retail. That is the big issue, Senator.

Much of the gasoline moving through jobbers never touches the bulk storage plants. It is moved directly from a terminal point of the source of supply—the refining oil company—directly to the retail outlet of the jobber.

Though he has transportation costs and some paperwork, that is substantially his cost factor which is involved in the movement and the advantage of 4 to 4½ cents and additional allowances when the companies decide to deviate from the normal of 4 to 4½ cents.

The CHAIRMAN. Mr. Campbell has talked about the problems with refiners while you have focused on jobber-related problems. Which group do you believe creates a greater problem for independent service station dealers?

Mr. HOUSTON. Both groups are creating major problems for independent retail dealers. The refiners are sophisticated enough, as they were in 1976, 1977, and 1978 before the Petroleum Marketing Practices Act was passed and adopted by this Congress, to reduce and almost totally eliminate the abuses in the market system prior to enactment of that law.

Refiners have likewise reduced the amount of abusive pricing in competition with dealers since the Congress last year started considering this legislation.

They are not as critical a problem in the marketplace today for us as jobbers who have not been too hesitant—in fact, they have not been hesitant at all—to more aggressively move forward and compete against their own retailers by utilizing their advantage in buying price.

That advantage has gone from 2 or 3 cents in lower prices in the marketplace to as much as 7 and almost 8 cents. In fact, I have for the record here a dealer who has drawn a map and attached the documents to prove what his wholesale price is and what the retail price of his supplier across the street from him is to show that it is almost 8 cents a gallon.

The dealer says: I have these stations of my supplier all around me. Now he is opening one across the street, and I see the whites of his eyes. There is nothing else I can do. I cannot compete against him. He is 7 cents a gallon below my wholesale price.

Senator, he cannot survive.

I would ask that the dealer's map, documents and his statement, be put into the record as evidence that there is a need for corrective legislation.

The CHAIRMAN. In your opinion, do direct pricing provisions require a jobber to perform his functions at cost? If so, what incentive would he have to continue these functions?

Mr. HOUSTON. Senator, this bill, when properly amended to preserve and protect the jobber's functional allowance, will not interfere with the operation of a jobber and his ability to survive in the future and to prosper in the future.

The only element that affects the jobber in the passage of this bill would be that he has been denied the right to buy at an advantage in price and to compete against retailers who are locked to him in paying a higher price.

That is the issue that is at stake in the passage of this bill.

I would like to point out that the present language of the bill, called "wholesale transfer of price," dealing with this issue was language that we thought was going to be compromise language with the National Oil Jobbers Council last year. In very good faith, we attempted to resolve our differences.

This language was requested by the National Oil Jobbers Council as a part of our compromise which they argued should not protect their functional allowance and that they were going to lose it anyway.

That is why it is missing.

We have offered the amendment in order to put it back into place, because we do think that they deserve the right to have it preserved.

The CHAIRMAN. Do you have figures on how many independent dealers have gone out of business since decontrol?

Mr. HOUSTON. Since January 28, 1981? No, sir, I do not have a study.

I can tell you that in representing the Service Station Dealers of America and in talking to representatives of more than half the dealers in this Nation, that we are in a critical posture of dealers hanging on by threads in the hopes that this Congress will correct the conditions in the market that will permit them to return to a profitable business and a competitive opportunity in the marketplace, recover their loss volumes, and pay back the bank loans and other borrowings they have had to go into in order to survive in this industry.

They will not survive much longer is what they say to me.

The CHAIRMAN. Would you respond to the contention raised during previous hearings on this bill that if cross-subsidization is occurring, it is more advantageous for major refiners to price company-operated station gasoline at or near the independent dealer price and pocket the extra money rather than run the risk of facing a large antitrust suit?

Mr. HOUSTON. I am not sure I understand the question well enough, Senator. Would you mind going through it again?

The CHAIRMAN. Would you respond to the contention raised during previous hearings on this bill that if cross-subsidization is occurring, it is more advantageous for major refiners to price company-operated station gasoline at or near the independent dealer price and pocket the extra money rather than run the risk of facing a large antitrust suit?

Mr. HOUSTON. I am not sure I am prepared to respond to that. It is a rather complex question.

I wonder if our counsel might respond.

Our counsel, Jerry Cohen, is here. If the chairman would permit, I would ask him to respond.

Mr. COHEN. The only response I would make, Mr. Chairman, is that there is no real problem that the majors are faced with in this area with any major antitrust litigation.

Since leaving this august committee—and I shared the chief counselship with Mr. Chumbris up here for a number of years on the Senate Antitrust Committee—my entire time has been spent in litigation in the courts.

In regard to the areas with which this legislation is concerned, I state without reservation and without qualification that the antitrust laws are totally useless to achieve any significant results.

Therefore, the very basis of the question—rather than face antitrust suits—I think has very, very little meaning.

I say that here without going into detail because I realize the time situation. If you desire, I could detail exactly why I think the antitrust laws can have no effect in this particular area.

The CHAIRMAN. Thank you.

Mr. Taylor, does Exxon operate any stations near you under the Exxon brand at which they have been underselling you?

Mr. TAYLOR. No, sir; they do not. They have one that they are closing up right now. It has been rumored for the last 3 months. They closed this station about 2 months ago, and it was strictly self-service, company-operated. They never priced less than 3 to 5 cents above their cost to the dealers or dealer tank wagons. If I was paying $1.23, they would retail gasoline for $1.28.

Half a block down the street, an independent marketer has just opened up a superduper 24 pump pumper. I think they feel that this is going to substantially cut their volume, and they want to get rid of it. They feel that it will be an unprofitable operation.

That is the only direct company operation of Exxon that is near me with any semblance of closeness.

The CHAIRMAN. Does the Exxon jobber you are now buying from operate Exxon stations as well? If so, has his pricing been hurting you?

Mr. TAYLOR. No, sir; he does not operate any retail outlets that I know of. He serves me gasoline for exactly the same price that I would pay for gasoline if I bought directly from Exxon Co.

The CHAIRMAN. Mr. Stanton, do you think that being a branded dealer gives you any advantage in competing with a nonbranded dealer when it comes to price?

Mr. STANTON. No, sir; it does not.

Being a branded dealer gives me an advantage in competing with a nonbranded?

No, sir. In today's market, it definitely does not. Brand is of little consequence in the Ohio market today.

The **Chairman**. Senator Metzenbaum had to leave. We will see if his counsel has some questions.

Ms. **Baker**. I just have a few questions, Mr. Chairman.

Mr. Houston, last year opponents of this legislation said that your problems would disappear if oil controls were lifted. Has decontrol diminished the need for this legislation in your view?

Mr. **Houston**. No. In fact, it has increased the need for the passage of law to correct the abuses in the system.

The freedom to move out without anyone looking over your shoulder and monitoring the activity has caused the jobbers to move very aggressively and exercise an opportunity to increase their sales substantially by lowering the price and destroying the competition.

Some refiners have likewise done this but to a much smaller degree.

Ms. **Baker**. One indication of competitiveness ought to be the degree to which there is mutual bargaining power in a contractual relationship. How would you describe the typical dealer's bargaining power vis-a-vis the major refiner?

Mr. **Houston**. The best way to describe it in the fewest words is to take it or leave it. There is no bargaining carried on to any great extent by the great masses of dealers.

Occasionally, we will find one dealer somewhere who has been able to bargain some condition. However, basically, the masses of dealers are not permitted to bargain but are merely offered a contract. They either accept or reject it.

Ms. **Baker**. I would be interested in having the dealers describe if they could the kinds of conditions typically imposed upon them or their colleagues currently.

Mr. **Houston**. The hours of operation, of course, continue to be a demand upon them.

The pool margining has become a great demand by some of the companies by bringing out elaborate paperwork to prove to the dealer that he can deceive the public into believing that prices are lowered at a station by lowering the leaded product, which is representing 20 or 25 percent of sales, to an unusually low price. Then by loading the other products so that when the consumer comes in he sees the low price on the street of the one price being posted, the motorist pulls in without looking at the unleaded gasoline prices and is entrapped perhaps into purchasing some product that is much higher than what he had conceived it would be when he drove into the facility.

I think that the companies have applied substantial pressures to this degree.

In the case of the Texaco situation, a 40-year Texaco dealer was approached by his representative a few weeks ago in Atlanta, remembering now that these 20 new self-service centers are in process where the company is selling in many of these locations for low wholesale price.

He comes in and says: You dealers will either have to come to a 6 cents per gallon markup on gasoline on the price we charge you or you may as well be prepared to get out of the business.

This is a man who survived 40 years in the business being told by what he referred to as a green representative from the company who did not understand that he should not be out there telling him what he was going to have to sell his gasoline at if he wanted to survive.

Ms. **Baker**. How do you reconcile what we have been hearing today regarding predatory practices by the refiners with the findings in the title III study by DOE?

Mr. **Houston**. The predatory practices are real in the marketplace. Perhaps predatory costing is more appropriate.

Predatory it is when it destroys the competition, and it is destroying independent dealers in the process. When the supplier loads the price to the dealer to the extent that he is unable to compete then at retail with the price that supplier has on the street, then I consider that predatory.

I do not believe that the DOE report was adequately done or properly done within the framework ordered by the Congress. I would defer any further response to that to Dr. Allvine who has done extensive work and study of the DOE report.

Ms. **Baker**. I wonder to save the committee's time at this point if we could have something in writing.

Mr. **Houston**. I believe his statement just submitted for the record has complete analysis dealing with this issue and would be possibly adequate to deal with that.

Ms. **Baker**. It has been suggested by opponents of this matter that the open supply provisions will destroy the marketing of gasoline through branded stations. Would you comment on that? Do you agree?

Mr. **Houston**. I cannot conceive of brand identity disappearing in the gasoline industry, any more than I would conceive that it would disappear from GE toasters or any other merchandise which is being placed before the consumers today.

There is value in brand identity, continuity, and uniformity of advertising and other support means to convince the public that this is a product to buy.

I cannot conceive of a company sacrificing the tremendous differentials in price which it is capable of obtaining with a brand versus a nonbrand.

You look at the private brand industry today and see the difference in the price that the product is reaching the retail dealers who buy from private brand, versus the price that comes from a branded supplier. It is so great that I think it would shock the stockholders into a rebellion against the company if it, in fact, tried to sacrifice that brand identity.

It may be that someday brand will disappear because gasoline is gasoline. There has been a tendency to play with this to the extent that brand has been discredited. At this time, I cannot conceive of them sacrificing the brand identity on the product.

Ms. **Baker**. We keep hearing about refiners selling gasoline on the street at less than they are selling it to you at wholesale. If this is the case, how would the American consumer benefit by divorcement, which would put an end to the refiner operations?

Mr. HOUSTON. Remembering, first of all, that today approximately 25 percent of the product is reaching the consumer at a lower price than it is reaching through the other 75 percent at the dealer wholesale level—that being the case, I think that the consumer who is buying from the other 75 percent is paying the cost for giving the 25 percent the advantage.

It is my contention that the consumer will benefit by a proper charge for the product with across the table pricing and no under the table dealing, and that real competition among tens of thousands of dealers would result in a much better and much lower price to the public than would ever develop in a long-range appearance and consideration of only 15 or 16 companies controlling retailing as they control other elements of the oil industry.

Ms. BAKER. Basically, you are concerned about what would happen in the long run if these practices were permitted to continue indefinitely.

Mr. HOUSTON. I think there is a shortrun advantage to consumers to enact this legislation.

At this very moment, there are consumers complaining daily who cannot locate essential services with a product. That service is absolutely necessary if this society continues in its posture for the last few years and the economy continues as it is today of mobility being a part of the economy. We must have the ability to quickly service those vehicles along with the network of facilities that provide that product. They are inseparable.

At the same time, I would not suggest at all that consumers should not have the opportunity to buy at self-serve. Self-serve is here.

Ms. BAKER. There is no reason why the independents could not operate those.

Mr. HOUSTON. Some self-serve is operated by dealers today as efficiently and as high volume as anyone else and is managed perhaps better than the employee of a company operation of the same type.

We could call names and present statements to that effect of where these stations are.

Ms. BAKER. Because of the time constraints, I am going to stop here.

We may have some questions in writing if that is all right.

The CHAIRMAN. That would be all right.

Ms. BAKER. Thank you.

The CHAIRMAN. Will you answer some questions for the record if we have them?

Mr. HOUSTON. I certainly would, Mr. Chairman.

The CHAIRMAN. We have another hearing at 2 o'clock in this room.

I think this completes the panel.

Mr. HOUSTON. May I ask the chairman to allow me to put into the record my analysis of the Maryland pricing which I have circulated to the committee? It is one page, printed on both sides.

In support of that, I have a complete copy of the Maryland court decision on the Maryland law so that there is a basis for this to be in the record.

The CHAIRMAN. We will take the one-page item for the record. The other we will just turn over to the committee for reference.

Mr. HOUSTON. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you all, gentlemen.

[Material follows:]

PREPARED STATEMENT OF JACK W. HOUSTON

MR. CHAIRMAN, my name is Jack W. Houston. I am the Chairman of the Government Affairs Committee and formerly Acting Executive Director of the Service Station Dealers of America (SSDA), formerly the National Congress of Petroleum Retailers. We represent nearly 60,000 gasoline retail dealers who are members of our affiliated dealer associations located in 42 states, the District of Columbia, and Puerto Rico. We are most appreciative of the opportunity to appear here today to testify relative to S.326, the Small Business Motor Fuel Marketer Preservation Act of 1981.

We hope that at this forum you and the members of your Committee, as well as your colleagues in the full Senate, will see the wisdom and merit of enacting into law this crucial piece of legislation.

This legislation is crucial for two reasons: (1) It means that upon its enactment the independent franchise gasoline dealer will have an opportunity to function in the marketplace as an independent small businessman. (2) The enactment of this legislation will allow for free competition in the marketplace and thus will be of the greatest benefit to the ultimate consumer of retail gasoline.

The substance of the legislative proposal that is now before you is a proposal to provide some basic fairness to assure that free market conditions will prevail in the future in the public interest.

We ask for your support and for your vote to correct certain marketing practices of refiners and local jobber-distributors which are causing the untimely and unjustified destruction of competition and the removal of small businesses from the retail marketing of motor fuels. To prevent this destruction it is essential that Congress require equitable distribution of products at equitable prices. Decontrol only serves to emphasize the urgency for Congressional action in that those who have engaged in the marketing practices which make this legislation necessary may now accelerate their activities at will, thereby speeding up the demise of competition and small business in gasoline marketing.

The more crucial provisions of the legislation are both reasonable and of material significance to future gasoline marketing. They contain the essential ingredients for real competition among large number of small business persons for maximum benefit to consumers.

Jobbers have recently become the principal gasoline marketers surpassing 51% share of the United States gasoline market (November, 1981). In 1975 their share of the market was only 41%. More growth is predicted. (See Lundberg Letter, March 27, 1981).

How could jobbers grow so much in a period that has witnessed tens of thousands of dealers exiting retail marketing?

The evidence of how jobbers have grown is obvious. Jobbers moved aggesssively to have employees operate their own company stores. Jobbers have also made deals with convenience food store operators whom they pay to collect monies from the customers of self-service pumps owned and controlled by the jobber. Using their jobber buying power (buying for resale to dealers) they have continued to hold their dealer wholesale prices high while transferring product to their own company stores and the convenience food store operations where they have sold gasoline at retail prices that is at, near, and most often below the wholesale price these jobbers have charged their dealers. In substantially all cases, the jobber retail prices do not cover the wholesale price the jobbers charge their dealers plus the cost of operating the retail outlet.

Jobbers are not growing because of their efficiencies or because of innovated marketing techniques. Jobbers are growing because they have the advantage in buying price. They are destroying dealers. They are destroying competition in the retailing of gasoline.

A recent memorandum issued by the National Oil Jobbers Council's attorney suggested ways jobbers can remove their dealers from the protections of the Petroleum Marketing Practices Act. If NOJC's approach succeeds, then dealers who lose their rights under the Petroleum Marketing Practices Act could then expect to receive abrupt termination notices and jobbers will then take over those locations.

Can the consumer expect jobbers to continue lower prices, sacrifice of their advantage in wholesale buying prices, after jobbers have substantially captured the market? No! Once dealers are gone from the marketplace, jobbers will move to recapture retail margins to go along with their wholesale margins. The lesser competition in the marketplace caused by the elimination of the large number of independent retail dealers will also encourage jobbers to move aggressively even higher for greater margins in the future.

The marketing practices of many jobbers and of many refiners undermine the competitive process.

The practices of jobbers and of refiners which the bill is intended to correct have been documented time and time again in hearings before Congressional Committees, and I do not intend to reiterate them in the time allowed here. Suffice it to say that the record is complete and overflowing in support for Congressional action. In particular, we refer to the testimony submitted to this Committee in the 96th Congress, 2nd Session, on S.2798 and the three-volume record of the House Small Business Committee Subcommittee developed in conducting hearings in major cities across the nation during 1979. In addition, "The Case For Legislative Relief From The Impending Destruction of Small Business And Competition In The Gasoline Industry," a copyrighted work, Allvine/Houston/Phillips, January 22, 1980, provides a comprehensive in-depth composite of documented data from authoritative sources. A copy is attached, and we respectfully ask that it be attached to the record of this hearing.

In separate testimony before this Committee, Professor John J. Flynn has focused your attention on valid arguments for enacting structural changes, including divorcement of the largest refiners from retailing of motor fuels. He also has pointed out some of the deficiencies of the conclusion drawn and published in the final report by the Office of Competition (Title III of Public Law 95-297).

Professor Flynn's reputation, knowledge, understanding and expertise and his past experience as repected Counsel to this Committee lends weight to our plea that anticompetitive practices which exists, whether intentional or unintentional on the part of suppliers, is detrimental to competition and small business opportunities in the gasoline (retail) industry.

The market must be structured and pricing equalized in such a way as to eliminate the practices which have proven to be anti-competitive in the past and which continue today. This is what the bill intends to do.

It is important also that this Committee understand the motive behind the Service Station Dealers of America's urging of divorcement of certain refiners from the operation of, but not the ownership of, retail outlets. This point and 19 others are briefly explained in the 1981 copyrighted "Twenty Questions & Answers" (attached for inclusion in the record) which I prepared and published as Government Affairs Committee Chairman of the Service Station Dealers of America.

The point is, it is timely for The Congress to make judgment as to whether the largest refiners will be permitted an opportunity in the future to gain the same control on the retail segment of the industry as they now have on all other segments of the industry and in certain other energy related fields.

The market mechanism, tempered by antitrust statutes and other economic legislation, has been the cornerstone of growth and development throughout most of the U.S. economy. It is this market mechanism which must be corrected. S.326 can successfully accomplish that need with a few changes.

SSDA urges this Committee to amend S.326 to the wording appearing in H.R.1362, the House companion bill.

The specific differences are:

(1) S.326 should contain the "financial assistance to Small Business Concerns Acquiring Motor Fuel Service Stations (Sec. 2 of H.R.1362);

(2) S.326 should contain the refiner sales ratio limitations (Sec. 3b of H.R.1362);

(3) S.326 should prohibit all suppliers from earning less on sales at retail than they would have earned if the same product had been sold at wholesale (Sec.3(c)(2) of H.R.1362);

(4) S.326 should contain the words "but not to exceed" in Sec. 2(b)(2)(B) so as to prohibit the suppliers from using their vast economic resources to destroy competitors (Sec. 3(c)(3)(B) of H.R.1362).

(5) Additional definitions and/or penalties to accommodate the above amendments.

Here are our reasonings on the four points:

(1) Present law is inadequate to allow SBA to guarantee loans on real estate. More specific rights are needed for dealer options to assure the proprietor of any leased service station that is offered for sale by a refiner shall have the right of first refusal to purchase the station.

SSDA also asks that this section be broadened to include all suppliers instead of just refiners so that the proprietors of any leased service station that is offered for sale by a jobber distributor would also be required to extend first option to purchase to the dealers who otherwise would be subject to having the property sold out from under him and to destruction of his on-going business.

(2) Without the restraints proposed by this amendment, the small or independent refiners are invited and encouraged to expand sales at motor fuel retail service stations it employee operates and subsequently to discontinue all sales to dealer operated stations. If this happens, SSDA is concerned that Sec. 2(b) would be inapplicable and therefore would selectively permit up-stream profits to be utilized while otherwise denying this right to other refiners.

(3) This amendment to prohibit all suppliers from earning less on sales at retail than they would have earned if the same product had been sold at wholesale is an essential ingredient that corrects the greatest current marketing practice abuse that is destroying competition and the dealer operated service stations. The language appeared in S.2798, 96th Congress. In the haste to draft compromise language with NOJC, SSDA accidently dropped this wording. Consequently the attempted compromised bill inadvertently omitted this essential wording if Congress intends to stop the destruction of competition and of dealer operated service stations by suppliers who have engaged in such practices.

SSDA asks your acceptance of our apology for the omission and urges this Committee to insert this important language in S.326.

Since private brand retail outlet operations are more freely able to obtain quotes for product than are branded retail outlet service stations, failure to include "but not to exceed" in Sec. 2(b)(2)(B) will substantially expand the non-cost-justified differentials. The offering of surplus gasoline at distress prices to such purchasers while contemporaneously holding the wholesale prices charged branded dealers at a higher rate must be successfully dealt with to give the branded dealer a fighting chance in the marketplace.

In addition to these amendments, SSDA asks consideration by the Committee to shorten the time for enforcement on all sections of S.326, with the exception perhaps of one year being allowed refiners who must select, train and install dealers in former employee-operated company stores.

Three to six months would be adequate time to comply with all other provisions of S.326. Particularly is it important to shorten the time to comply with the anti-competitive pricing practices that are daily forcing more dealers out of the marketplace.

With the adjustments this proposed legislation narrowly focuses on the anti-competitive conduct of those suppliers who are guilty of such conduct. The adoption of this legislation will therefore not injure nor interfere with those suppliers who are not engaged in such anti-competitive conduct. The banning of all suppliers from such anticompetitive conduct is an appropriate response for The Congress. These additional legislative remedies are required. Our concerns for our members and our concerns for the public interest are real.

Finally, Mr. Chairman, in testimony before the Subcommittee on Energy, Environment and Safety Issues Affecting Small Business of the Small Business Committee of the House of Representatives of April 1, 1981, we offered an amendment to H.R.1362 which would protect the jobber functional discount (JFD) for that middleman role traditionally played by the jobber.

Mr. Chairman, this Committee should be made fully aware of our good faith efforts to reconcile our differences with jobbers and with refiners. Those efforts are fully detailed in Appendix A attached to this statement which I ask be made a part of this record. However, we are trying to meet what appears to be the jobbers' primary concern, i.e., the inability to compete against employee-operated outlets with their own (jobber) employee-operated outlets because they contend that their cost under H.R.1362 would be higher than what a refiner would be permitted to sell in the same market.

Our response to this concern of the jobber is to amend the legislation by adding the word "storage" after the word "sale" on line 7, page 4 of S.326. The reason for this is that jobbers have argued that they should be entitled to a discount relating to the functions which they perform. Section 3(a) with the amendment recommended above would allow differentials in prices which would make due allowances for any and all of the functions which a jobber might perform. To the extent that a jobber makes his own deliveries, he would be entitled to an allowance for the cost of that function. To the extent that a jobber maintains his own storage facilities, he would be entitled to an allowance for the cost incidental to such storage. This should remove any legitimate objections the jobbers might have to this bill. See Appendix A(1) & (2).

This bill approaches the basic problems facing the dealers in two significant ways. The first is structural and the second behavioral.

In regard to the structural approach, so long as major refiners are allowed to operate their own retail outlets, it is impossible to have a marketplace in which fair competition can prevail. Nor will all the laws in the world aimed at correcting behavior be helpful where that kind of anti-competitive structure exists. This is so because of the mammoth resources the major refiners bring to the marketplace. No small businessman can successfully compet with a billion dollar corporation totally integrated from wellhead to gas tank. This structure allows the refiners to use their upstream profits, whether they be from producing, refining or the operating of pipelines, to subsidize their retail operations. That they have done this continuously and effectively to destroy independent business is without question. I say this unequivocally despite the DOE Part III Report upon which I am submitting a separate statement which demonstrates the fallacies contained in that report.

Certainly, it is time for Congress to make a judgment as to whether the largest refiners will be permitted an opportunity in the future to have the same control over the retail segment of the industry as they now have over all other segments in addition to certain other energy-related fields. What S.326 can successfully accomplish is the correction of market mechanisms that will allow free enterprise to fairly work in the retailing of gasoline.

Specifically, the divorcement provision applies to only a few refiners who would simply be required to reverse a situation of unfair competitive advantage that if left unchecked provides the opportunity for manipulating, controlling and ultimately taking possession of the retailing of petroleum products. The number of retail outlets which these refiners will be required to divorce themselves from is such that it will cause little more than a temporary inconvenience as they locate dealers for such outlets. Thus, there will be no substantial injury to these refiners as a result of the passage of this legislation.

The actions of some of the refiners have severely crippled competition and have destroyed independent dealer operations in the vicinity of such company stores. Early passage of S.326 will avoid a greater effect than would obviously result if these largest refiners are permitted to continue their forward integration into retailing of motor fuel.

Other refiners will not be adversely affected nor will they be denied the opportunity to remain in retailing under the reasonable conditions that are required by this legislation.

Jobbers may continue to operate employee-operated retail outlets after enactment of S.326. They can then prove that they are more efficient (can sell at lower retail prices) than the dealers without the use of favored wholesale buying prices, if in fact they are. Other refiners who continue to employee-operate company stores will likewise have the opportunity.

The second portion of the bill is behavioral, and it is nothing more or less than a measure to require equitable price availability to all retailers. This simply means that all the runners in the competitive race begin at the same starting point.

Equitable pricing will correct the situation by which suppliers have been able to unfairly compete with their own customers at wholesale by selling at retail at less than the cost of operating the retail outlets plus the wholesale price for the product they charge their wholesale customers. The adverse effect on competitive branded dealers located near company stores, whether independent refiners or jobbers, has forced many dealers out of the marketplace, and it was not and is not always the same brand dealers who are forced out of business by a company store.

The cost to consumers of the practices at which this bill is aimed can be measured in more than dollars alone. Consumers are threatened in many areas with great uncertainty in obtaining mechanical services as needed which are incidental to their day-to-day consumption of motor fuels. Without passage of this bill, that situation will become worse and worse.

In addition, increasing rental charges and shifting of maintenance costs to lessee dealers is imposing increasing costs upon the dealer operation at a time when the suppliers are earning less by selling at retail than they would have earned had they sold the same product at wholesale to the dealers.

Consumer demand has not declined significantly for full-service retail outlets. Suppliers, taking advantage of the increasing price of gasoline and their ability to sell at a retail price lower than that which a dealer-operator can charge and survive, have shifted the business from the full-service dealers over to the cheaper self-serve and gas-and-go-only type operations. Where consumer demand for full service is down, and where suppliers would make available retail outlets which are gas-and-go or self-serve only, the dealer operations would be as efficient or even more efficient in meeting the needs of the public.

Approximately half of the dealer-operated stations of the major refiners are dealers who either own and/or control by lease with a third party the retail properties upon which they operate. The destruction of these dealers, who do not lease the properties from the companies, is a destruction of the raw fiber of the very substance of the free enterprise system. These dealers cannot survive against the anticompetitive marketing practices which this legislation is intended to correct.

There is room in the marketplace for both high and low-volume outlets. Dealers are capable of operating both types of outlets efficiently if suppliers are not permitted to continue to reserve such outlets for themselves and/or to continue to charge a retail price to consumers in those employee-operated outlets which does not cover the wholesale price it charges its dealers and the cost of operating the retail outlet. Both types of facilities can serve the consumer well with enactment of the proper guidelines contained in S. 326; otherwise, competition and dealer-operated stations will disappear from the marketplace.

There are certain consumer rights that we believe the Congress would wish to make available within the framework of the free enterprise system in the gasoline industry. They are: (1) the right to convenient accessability; (2) the right to choose to purchase the product with or without service; (3) the right to availability of services with the product; (4) the right to the lowest price with maximum value from competition among equal competitors; and (5) the right to safety, convenience, and the satisfaction of dealing with small business dealers versus employees of a few giant corporations. Passage of S.326 will provide consumers with these rights.

The form of relief we seek by the passage of this legislation is the best approach we know to stop the forces that are destroying real competition in gasoline marketing. We do not want further regulatory controls. We desire this legislative correction which will provide accessible judicial relief and remedies in a court of law against those who would continue to tamper with the free market. This legislation then is intended to provide simple basic rules of fairness to assure that free market conditions will exist in gasoline marketing.

To conclude, we restate our initial caution that this legislation is crucial for two reasons: (1) Enactment of this legislation will permit the independent franchise gasoline dealer, as we have known him over the years, to have an opportunity to function in the marketplace as an independent small businessman; and (2) Enactment of this legislation will allow free competition in the marketplace and thus will be of the greatest benefit to the ultimate consumer of retail gasoline for their motor vehicles.

Thank you, Mr. Chairman, for the opportunity allowed the Service Station Dealers of America to express its views. If there are any questions, please permit us to respond. We believe that an understanding of the problems involved will hasten support of the legislation as recommended for amendment or some alternative that will adequately preserve competition and small business dealers in the gasoline industry.

APPENDIX A

Repeatedly since the initiation of the proposed legislation in early 1980, SSDA and its leaders have offered to work with the other segments of the industry in search of better solutions to the problems which this legislation seeks to address.

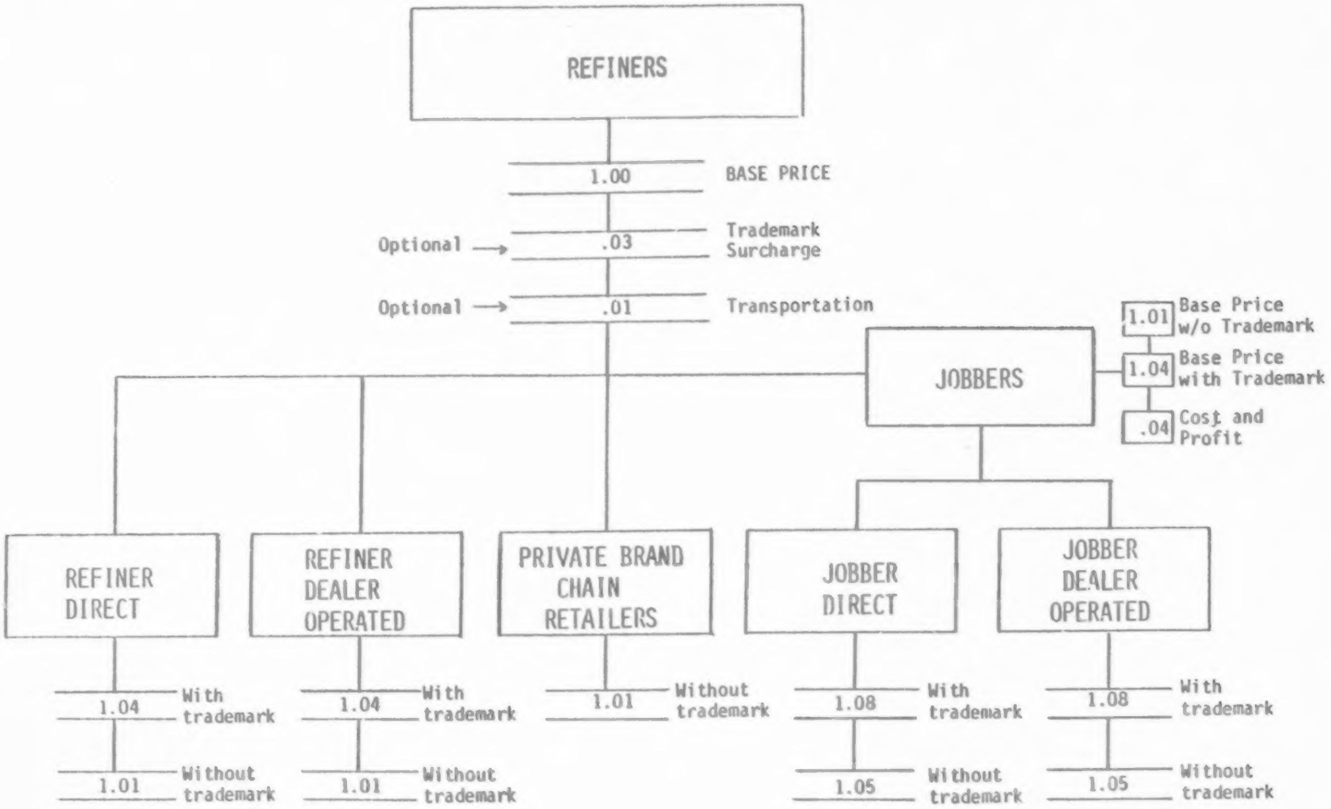
On our own volition and during the course of consideration of legislation to address these issues, certain leaders of the Congress, including the Chairman of this Committee, encouraged compromise with jobber leaders. With the help of Small Business Advocate Milton Stewart of the Small Business Administration, several attempts to reach mutually agreeable solution proposals failed. For hours we discussed in detail the problem, the proposed legislation then before the Congress, and what alternatives that may exist to deal effectively with the marketing practices we believe must be corrected to preserve competition and to provide opportunity for competition among reasonably equal competitors.

SSDA was first to come forward with proposed language to preserve jobbers' functional allowances where they actually performed the functions. Our attack has been on the marketing practice of jobbers using their special functional discount buying rights to compete against their own dealers and other dealers in the market system who are locked to higher dealer wholesale prices.

Finally, the National Oil Jobbers Council (NOJC) leadership did meet with SSDA leadership on November 19, 1980. NOJC representatives offered a compromise in concept consistent with their published proposal, Section 6 thereof, which more specifically dealt with supply protections for jobbers in addition to publicly proclaiming that refiners should not be permitted to compete at retail by transferring gasoline to their own retail outlets at less than the wholesale price they charge their dealers. The NOJC leaders repeatedly stressed that they fully expected and understood that the word "refiner" would be altered to cover all suppliers, including jobbers. NOJC also proposed that any supplier who also markets petroleum products transfer such product to any level of its own or affiliated company at a price to recover the cost of performing each marketing function involved.

The compromise language was perfected to adjust S.2798, the companion bill to H.R. 6722 last year, to the NOJC concept of posted wholesale transfer price. SSDA met every compromise request, accepted the compromise offer, and with approval of NOJC leaders paid its counselors to perfect the language which was submitted to the Senate Committee for consideration in the last session. NOJC ultimately rejected the compromise attempt its leadership originated. The Senate Committee inserted the NOJC proposal and voted 16 to 1 for the revised bill. We have, since the end of the 96th Congress, made several attempts to return to the conference table with NOJC leadership to work out mutually agreeable concepts that may be suggested to this Congress for dealing with the marketing practices that are destroying competition and dealer-operated service stations. It appears hopeless, and I, therefore, suggest to this Committee that this Congress should proceed with its best judgment and enact the necessary legislation to correct conditions in the retailing of gasoline.

APPENDIX A(1)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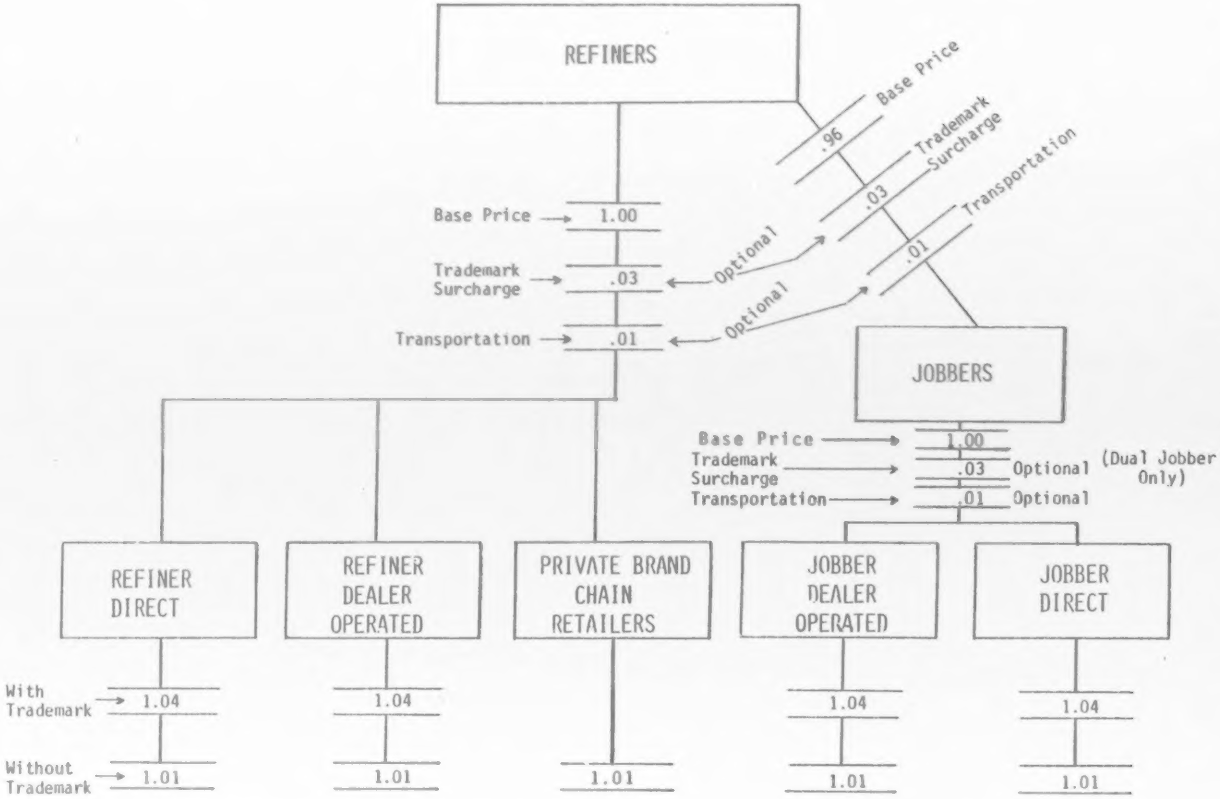
APPENDIX A(2)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Footnote: Excepting only due allowance for differences in cost of manufacturing, sale, storage, or delivery resulting from differing methods and quantities sold and delivered.

APPENDIX B

STATEMENT OF POSITION

SERVICE STATION DEALERS OF AMERICA

BY JACK W. HOUSTON, CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE

ON THE FINAL REPORT OF

THE STATE OF COMPETITION IN GASOLINE MARKETING

AS REQUIRED BY TITLE III OF THE PETROLEUM MARKETING PRACTICES ACT,
PUBLISHED JANUARY, 1981

BY THE U.S. DEPARTMENT OF ENERGY, OFFICE OF COMPETITION

Dealer-operated full service motor fuel service stations are a desirable form of competition. [1] "The market mechanism, tempered by anti-trust statutes and other economic legislation, has been the cornerstone of growth and development throughout most of the U.S. economy." [2]

"There is a need for federal legislation to insure that a retail sector at least as strong as today's is in existance after the coming evolution in the structure of the market has taken place". [3]

Though the authors of the Title III Report concluded that " ... competition is an inherently unfair process", the definition of competition offered by Senator Hollis as Congress enacted the FTC Act best described unfair competition when he said: " ... competition is unfair when it resorts to methods which shut-out competitors who by reason by their efficiency, might otherwise be able to continue in business and prosper". [4] Had the authors of the Title III Report applied this definition to the data examined, suppliers, both refiners and jobbers, would have been found to have been engaging in subsidizing and unfair marketing practices.

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[1] FTC, Docket 89-34, October 31, 1980, Exxon Corporation, ET AL, Complaints Counsel's First Statement of Issues ... page 367

[2] DOE Title III, Final Report, Chapter VIII, Recommendations, Summary, page 236

[3] Report 95-731, page 25, 95th Congress, Second Session, Report On The Petroleum Marketing Practices Act of 1978

[4] FTC, Docket 89-34, October 31, 1980, page 384

The authors said that even if they had found refiners had used a predatory campaign: "... the Department believes that banning all refiners from company-store operations is not the appropriate response, especially given the existing anti-trust laws." This is a biased opinion, notwithstanding that the anti-trust laws do not provide relief. However, even if relief is provided in existing anti-trust laws, the relief would not be reachable for small business or even by the federal government if FTC acting in the interest of small business sought to bring refiners and jobbers into the courts. The time required for prosecution would extend far beyond the period that competition and dealers will exist in gasoline marketing.

Mr. Chairman, it is indeed a sad state of affair to see the fully drawn conclusions, the innuendo and outright defensive commentary depicting a (refiner) protectionist attitude on the part of the authors of the Title III Study Final Report. And, an offensive technique was used by the authors to downgrade and nullify the values of the benefits derived and enjoyed by consumers from real competition among the remaining hundreds of thousands of dealers engaged in the marketing of petroleum products.

The Service Station Dealers of America wish to call to your attention certain relative points starting with Chapter VIII, Recommendations. The summary of this chapter wrongfully describes "... the most significant factor affecting gasoline marketing today is the DOE's price and allocation regulations." The most significant factor affecting (retail) gasoline marketing on the date the report was written and today is the marketing practices where suppliers (refiners and jobbers) are selling gasoline at retail at prices that are at, near, or below the wholesale price charged their dealer customers. When operating expenses for the retail outlet are considered, the widespread differential in the price charged by a supplier employer-operated outlet and a dealer-operated station which also must include operating expenses and pay a higher wholesale price fixed by the supplier, the dealer has no reasonable opportunity to be competitive, even though the dealer may be (and is in most cases) more efficient.

An " ... unfettered, competitive gasoline market" will best serve the economy and the Nation's consumers. But restraint of anti-competitive marketing practices is essential to a competitive market. Divorcement is essential for assuring a few refiners do not gain the same control over retail marketing of motor fuels as they now control 1) crude oil; 2) refining; 3) transportation; and, 4) wholesale pricing.

The authors " ... preferred alternative" to divorcement provides no relief. [5] The present anti-trust laws are not adequate nor reachable in time to save competition and dealers in the marketing of gasoline. Also, Congressionally enacted rights to redress in the courts against those who would destroy competition is not "tinkering with the markets" as claimed by the authors of the Title III Report.

Now that decontrol is a fact of life, there is less time left for the Congress to make a decision whether it will permit competition (and competitors) to be destroyed in the retailing of motor fuels.

The selection of choice words used by the authors in their statement of findings deserves close scrutiny. i.e. They said: "This study has found no evidence of pervasive predatory pricing practices by refiners at their company stores ..." Webster defines pervasive "to become diffused throughout every part of". This conclusion expressed by the authors after more than two years studying the marketplace was fully known by the Congress when it ordered the Title III Study. No one ever charged that all refiners were engaging in predatory pricing, or even that refiners who engaged in such practices were uniformly doing so through all their marketing regions. To the contrary, dealers testified that different market strategy for different markets was taking place among the various refiners.

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[5] See attachment - Appendix B(1), Letter to Representative John Dingell from SSDA General Counsel, Jerry Cohen

The authors have cast stones at the proposed legislation to correct the anti-competitive marketing practices of refiners and jobbers by claiming it protects "certain classes of competitors". Since the proposed legislation equally protects all competitors, excepting that the few larger refiners are proposed to be divorced to guarantee they will not take over the bulk of the retailing of gasoline, the authors suggest a remedy that is not applicable or reachable, thereby protecting refiners (one class of competitors) to continue their movement which is destroying competition (other competitors) in gasoline retailing.

Contrary to the authors' conclusions that the proposed legislation creates a barrier to entry, not only are the current refiner practices a full barrier to entry for small business persons who would be in an unequal posture to compete, but, if such practices continue the barriers will be permanent and competition (and competitors) will suffer to the detriment of consumers.

More than one-half of the branded dealers remaining in today's market own or control the station properties upon which they operate. The other half lease directly from refiners and/or jobbers. If refiners, who have been divorced, should turn to raising dealer rentals or the franchise fees as a means for transferring retail profits to themselves, there are intended and implied safeguards in the proposed legislation. The proposed legislation allows only due allowances for franchise fees to be added to the product prices. Dealers would have the option to drop the franchise fee if its cost became excessive and they could not be competitive by selling under the trademark. Unreasonable and excessive rental charges would cause dealers to relocate on properties not owned by the refiners. Refiners would not be expected to continue excessive and abusive rental rates if they had been divorced from retailing and would of necessity depend upon dealers to market their product.

The proposed legislation does not legislate uniform pricing across brand lines. The uniformity is in the requirement to treat all retailers purchasing on the same date from the same point of distribution in the same quantities by selling to such retailers at the same prices, excepting specified differentials permitted under the proposed act.

The appropriate business entities to receive competitive prices are competitors at the same level of distribution. Without this fairness, one competitor is disadvantaged when another is granted a favored price that is not cost justified when both are buying in the same quantities, from the same point of distribution, on the same date. The authors suggest dealers should not be given equal rights and therefore suggest consumers should not be protected against the destruction of competition in the marketing of gasoline.

The authors expressed a belief that a bait and switch system is the best way for dealers to get a good deal. All refiners are engaging in the practice of charging branded dealers higher prices than they charge competing dealers who purchase from the same point of distribution, in the same quantities, on the same date. Opportunities for dealers to switch brands are very few today ... and, opportunities will disappear in the future if dealers are to start at a starting gate which is forty yards behind their competitors (in price paid at wholesale). Particular is this true if the competitor is their own supplier with their brand within one-half mile or so of their station, to which product has been transferred, and the price at retail is to the consumer lower than the wholesale price the supplier charges the dealer. Anyway, if bait and switch has permitted dealers to enjoy "a good deal", it was shortlived. The good deals, such as rent concessions, always were adjusted immediately after the honeymoon period. Such practices gave the favored new dealer the edge over the proven long time customer of a supplier.

The full service dealers' skills as an entrepreneur, as a manager, and as a laborer, have made him an efficient small business person. Consumers have benefited. These same skills, excepting the personal labor services a dealer might perform at a full service station versus a self serve or gas and go outlet, are extremely valuable attributes for the operation of any type of gasoline marketing. Many dealers are already proving they are efficiently operating self serve and gas and go facilities of refiners who have not integrated foward into employee-operated retail outlets. If permitted the opportunity, dealers would prove their abilities to change and to operate whatever type retail gasoline facility the public desires. They cannot operate such facilities when suppliers reserve for themselves the newer marketing concept. (See Appendix B(2), February 1981 Survey Results - State of Georgia.)

A continuation of the conventional full service facilities is important. Such facilities should remain in the marketplace so long as consumers prefer this type of marketing with services. The conventional facilities should not be arbitrarily removed from the marketplace, particularly by anti-competitive market practices the proposed legislation is intended to correct.

In summary, the authors admit (page 242) that buying price differentials, financial discounts received by suppliers, and the relative inability to increase the volume of sales at individual dealer outlets have existed but will likely disappear in a decontrolled environment. Asking dealers to stand still while suppliers continue to aim their economic advantage guns to destroy dealers and competition in gasoline marketing is being less than honest. The authors are naive to think the problem created by suppliers engaging in anti-competitive marketing practices will fade away with the demise of federal price and allocation controls. The truth is these problems have intensified.

Mr. Chairman, we wish to also comment briefly on the netback methodology used in the report and the analysis of the subpoenaed documents. The netback methodology confused the issue and overshadowed the simple and obvious truth that some suppliers have used profits earned upstream to absorb would-be-losses in their company stores.

If as the authors claim, certain upstream costs are lowered when a supplier sells direct to consumers, why is it that none of the cost reductions were/are passed on to resellers?

When netback methodology is applied to retail marketing, the proper place to begin analysis is at the price charged to arms-length customers, resellers, as the product leaves the wholesale levels point of distribution. Allowing transfer to company stores at less than the price charged resellers is an advantage beyond overcoming by less than equals in relationships of resellers to suppliers.

There are three realities SSDA would like to call to your attention. The authors of the Title III Final Report acknowledged, but conveniently ignored: (1) That some suppliers, refiners and jobbers, have track records of destroying competition and dealers by engaging in anti-competitive activity, predatory in nature, at various terms and in selected markets; (2) that positive netbacks would have been negative netbacks had the suppliers actually transferred the products at the same prices they charged resellers; and (3) that had the authors separately analyzed leaded motor fuel sales instead of lumping them with unleaded sales, most, if not all, netbacks would have been negative for all the refiners with company stores.

Suppliers, refiners and jobbers, have used regular leaded as a loss leader. It was not an uncommon practice for suppliers to cover their costs and earn some profits on unleaded sales in company stores. Thus, the authors of the report have hidden the extreme negative netbacks that otherwise would have been disclosed had regular leaded motor fuel sales by the refiners been separately studied.

The authors drew the conclusion that "the preceding analysis has shown that 'predatory pricing at refiner-operated outlets is not being practiced by refiners on an industrywide basis'." (Page 95, underscore added for emphasis.)

This conclusion confirms that predatory pricing has taken place in selected markets by some refiners. The record supports the conclusion.

The final report noticeably ignored the predatory actions of jobbers whose practices were clearly and factually supported in the earlier report filed by the same authors.

APPENDIX B(1)

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June 16, 1980

The Hon. John D. Dingell
House of Representatives
2221 Rayburn Building
Washington, D. C. 20515

Re: H.R. 6722 and Related Bills

Dear Congressman Dingell:

On behalf of the Service Station Dealers of America, Inc., (SSDA), we would like to take this opportunity to advise the Committee as to what we believe are certain inaccuracies in the protective scope of the Robinson-Patman Act which were recently related by the Department of Justice and Federal Trade Commission. It was the position of these agencies that the restructuring of the retail gasoline industry required by H.R. 6722 ("the bill") is unnecessary because the evils sought to be remedied are currently prohibited by and are enforceable under the Robinson-Patman Act.

This is not so.

First, the Robinson-Patman Act is a complicated piece of legislation which requires individualized station-by-station treatment. Rowe, Price Discrimination Under the Robinson-Patman Act (1962). The limited protections afforded by the Act have been the subject of diverse judicial opinions and non-uniform application. What the bill seeks to provide is a single unitary tool to be applied equally nationwide to avoid undue economic concentration and anticompetitive retail gasoline marketing.

Second, there are severe technical difficulties inherent in the Robinson-Patman Act which do not come anywhere near approaching the fullness of the prohibitions in the proposed legislation. Under the Robinson-Patman Act, courts have found they have no jurisdiction over cases in which a parent was supplying its own subsidiary--for example, a refiner supplying its own company-operated gasoline retail outlet. As stated in Security Tire & Rubber Co. v. Gates Rubber Co., 598 F.2d 962 (5th Cir. 1979):

> "Transfers from a parent corporation to its wholly-owned subsidiary corporation are transfers within the same economic unit.

> These transfers are the economic equivalent of intra-company transfers of goods. As such, these transfers cannot be considered sales for Robinson-Patman Act purposes. See generally authorities cited in note 1, supra. See also generally Von Kalinowski, Antitrust Laws & Trade Regulation § 24.-03[2] (1975)." Gates, at 966.

The Court went on to find:

> "...The Robinson-Patman Act separates out and makes illegal competitively harmful discrimination. Intra-corporate transfers and transfers between parent and wholly-owned subsidiary are not the type of transactions the Robinson-Patman Act meant to regulate." Gates, at 967.

The Court concluded that where the,

> "...substance of...[a] marketing technique... [is] simply that a single economic unit "manufactured and marketed its product... a parent corporation's transfers to its wholly-owned subsidiary may not be considered separate sales to a favored customer in a Robinson-Patman Act price discrimination suit." Gates, at 967.

See also, Schaben v. Samuel Moore & Co., 462 F. Supp. 1321 (W.D. Iowa 1978), affirmed, 606 F.2d 831 (8th Cir. 1979). Although the Eighth Circuit reached the same conclusion on the facts in Schaben, they specifically refused to accept the Fifth Circuit's per se rule of non-liability for wholly-owned subsidiaries. 606 F.2d 831 at 833 fn. 3. However, the Sixth Circuit apparently has adopted the per se rule of the Fifth Circuit. See Parrish v. Cox, 586 F.2d 9 at 11, 12 (6th Cir. 1978). This expression of disagreement emphasizes the need for a uniform effort to restructure the industry separate from presently existing standards.

Moreover, there are substantial impediments to the protections afforded by the Robinson-Patman Act by reason of the geographic location of service stations. In those states having refineries, it is doubtful that a retailer could invoke the proscriptions of the Robinson-Patman Act against an encroaching refinery. In those cases, courts have held that the refiner's sales to stations located within the refinery state are not "in commerce" as required by Section 2(a) of the Robinson-Patman Act. See Standard Oil Co. v. Federal Trade Commission, 340 U.S. 231 at 240 (1951) and Borden Co. v. Federal Trade Commission, 339 F.2d 953 (7th Cir. 1964).

Additionally, certain courts have held that the transport of crude oil from one state to the next breaks the chain of interstate commerce and that subsequent sales of refined gasoline made from the point of transfer are not within "the flow of interstate commerce." See Belliston v. Texaco, Inc., 455 F.2d 175 (10th Cir. 1972).

In finding that no interstate commerce was involved in Belliston, the Court relied upon the decision of the District Court in Myers v. Shell Oil Co., 96 F. Supp. 670 (S.D. Cal. 1951), in which the Court held:

> "...that the Robinson-Patman Act did not apply to Shell with respect to gasoline it refined from crude oil which Shell itself had imported across state lines into California where the alleged discriminatory sales occurred."

In Belliston, the Tenth Circuit stated:

> "The lower court held that crude oil and gasoline are the same, i. e., petroleum products. This determination is a requisite for jurisdiction under the 'flow of commerce theory' because only the crude oil crossed the Utah state line. The lower court erred in this conclusion." Belliston at 179-80.
>
> "...The production of gasoline from crude oil is a highly complex process requiring expensive, precision equipment and skilled technicians. We therefore conclude that when crude oil is refined into gasoline, the character of these products is so changed that they cannot be equated as the 'same stuff' to satisfy the requirements of the 'flow of commerce' theory." at 180.

See also, Mowrey v. Standard Oil Co. of Ohio, 463 F. Supp. 762 (W.D. Ohio 1976) 773-75; McGoffin v. Sun Oil Co., 539 F.2d 1245 (10th Cir. 1976); Roorda v. American Oil Co., 446 F. Supp. 939 (W.D. N.Y. 1978) at 941-46.

The present provisions of the Robinson-Patman Act afford no protection to independent retail dealers from the economic concentration activities sought to be regulated in H.R. 6722 and related bills. If Congress determines that such a restructuring is in the public interest, which SSDA strongly contends, both from an economic and competitive standpoint, then the only way to effectively prohibit such conduct and enforce these purposes is by enactment of these new bills.

Sincerely,

Jerry S. Cohen

JSC:sf

bcc: Mr. Jack Houston

APPENDIX B(2)

Georgia Association of Petroleum Retailers, Inc.

APPENDIX B(2)

FINDINGS ... SPECIAL SURVEY ... FEBRUARY 1981

PURPOSE OF SURVEY -

To determine the extent that suppliers, major oil companies and their local jobber distributors, are engaged in retailing of motor fuels to consumers using employee-operated retail outlets to compete against their retail dealers ... and for other purposes.

FINDINGS - METROPOLITIAN MARKETS

1. Suppliers employee-operate:

   6.0% of all Full Service Stations
   75.4% of all Self Service Stations
   59.7% of all Gas & Go Outlets;

2. Dealers, doing business as independent small business persons, operate:

   94.0% of all Full Service Stations
   24.6% of all Self Service Stations
   40.3% of all Gas & Go Outlets.

FINDINGS - URBAN & RURAL MARKETS:

1. Suppliers employee-operate:

   23.3% of all Full Service Stations
   45.0% of all Self Service Stations
   46.1% of all Gas & Go Outlets;

2. Dealers, doing business as independent small business persons, operate:

   76.7% of all Full Service Stations
   55.0% of all Self Service Stations
   53.9% of all Gas & Go Outlets.

OTHER FINDINGS -

1. 20.6% of the dealers participating in the survey have as their competitor their own supplier who is employee-operating a retail outlet within one-half mile;

2. 20% of the Metropolitian market area dealers reported that their suppliers have notified them that their stations will be closed at the end of their lease because their volumes of motor fuel (gallons) sold are too low; 84% of these suppliers are refiners, major oil companies, 16% jobber distributors of the refiners;

3. 7% of the local jobber distributor supplied dealers reported receipt of notice that their stations will also be closed because of the lower volume of gallons sold;

4. The weighted average of all stations which have been given notices of intentions to be closed was 11.2% of the total number of dealers participating in the survey;

5. 40% of the dealers who expect to be shut down sell between 40 to 50 thousand gallons of motor fuels per month; 30% sell from 20 to 30 thousand; 30% sell between 10 to 20 thousand gallons per month.

PERTINENT DATA TO SURVEY FINDINGS -

1. 27% of all gasoline outlets in Georgia were included in the survey;

2. Metropolitian Market area dealer participants averaged 8.2 dispensing pumps per station; urban & rural averaged 5.4 each;

3. The number of dealers participating in Metropolitian Markets and the urban rural markets were almost equal;

4. Three classifications of stations, full service stations, self service stations, and gas & go outlets, were identified. Convenience food stores with pumps were included as self service stations.

5. Most self service stations and many gas & go outlets began operating since the 1973 shortage - illustrating in the survey results the substantial number which have been reserved by suppliers for their own employee operations - thereby accounting for the shift in market share away from dealers and to the suppliers.

6. Of the total number of stations covered in the survey, 53% were full service stations; 23% were self service stations and 24% were gas & go outlets.

For More Information
Contact: Jack W. Houston
Executive Director
404/377-3648
373-0605

CHART #1

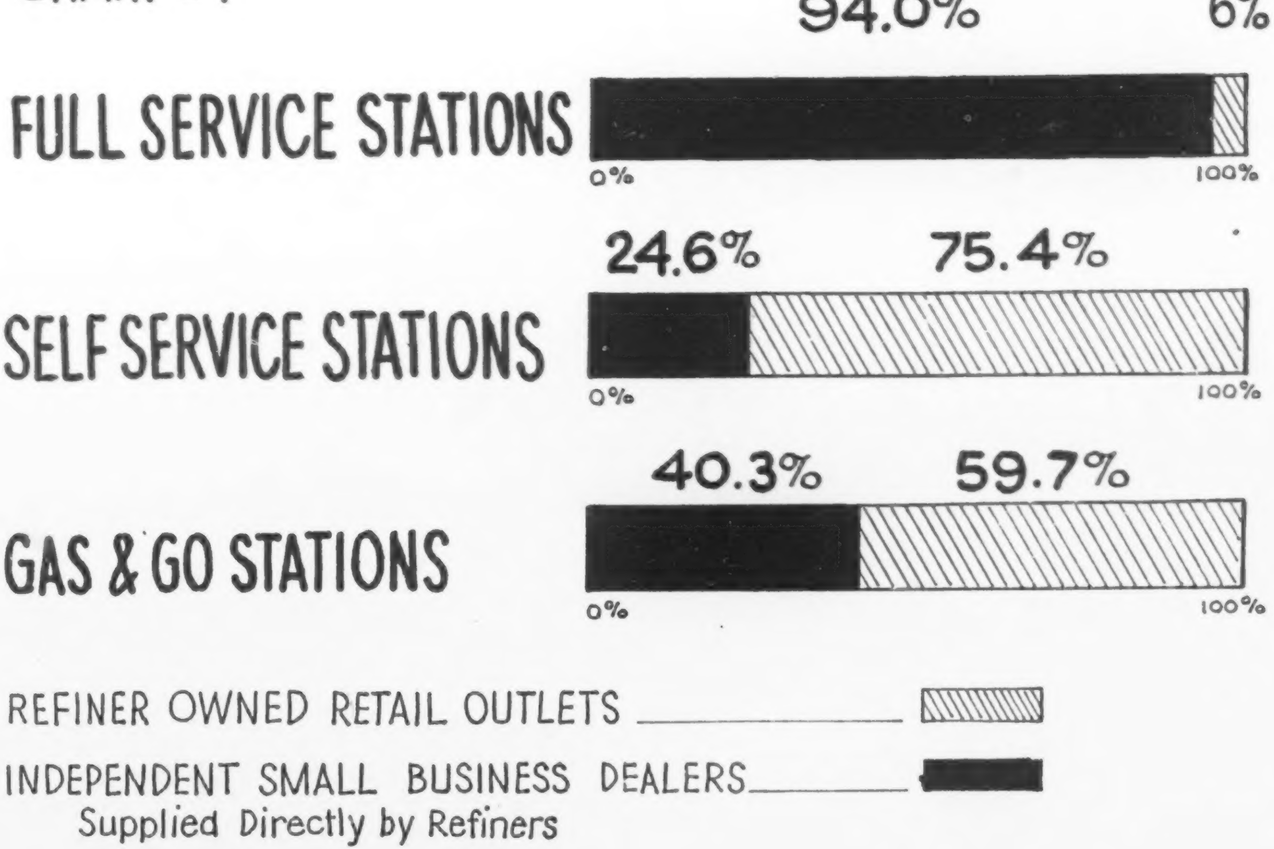

94.0%
6%
FULL SERVICE STATIONS
0%
100%
24.6%
75.4%
SELF SERVICE STATIONS
0%
100%
40.3%
59.7%
GAS & GO STATIONS
0%
100%
REFINER OWNED RETAIL OUTLETS ▨
INDEPENDENT SMALL BUSINESS DEALERS ■
Supplied Directly by Refiners

CHART #2

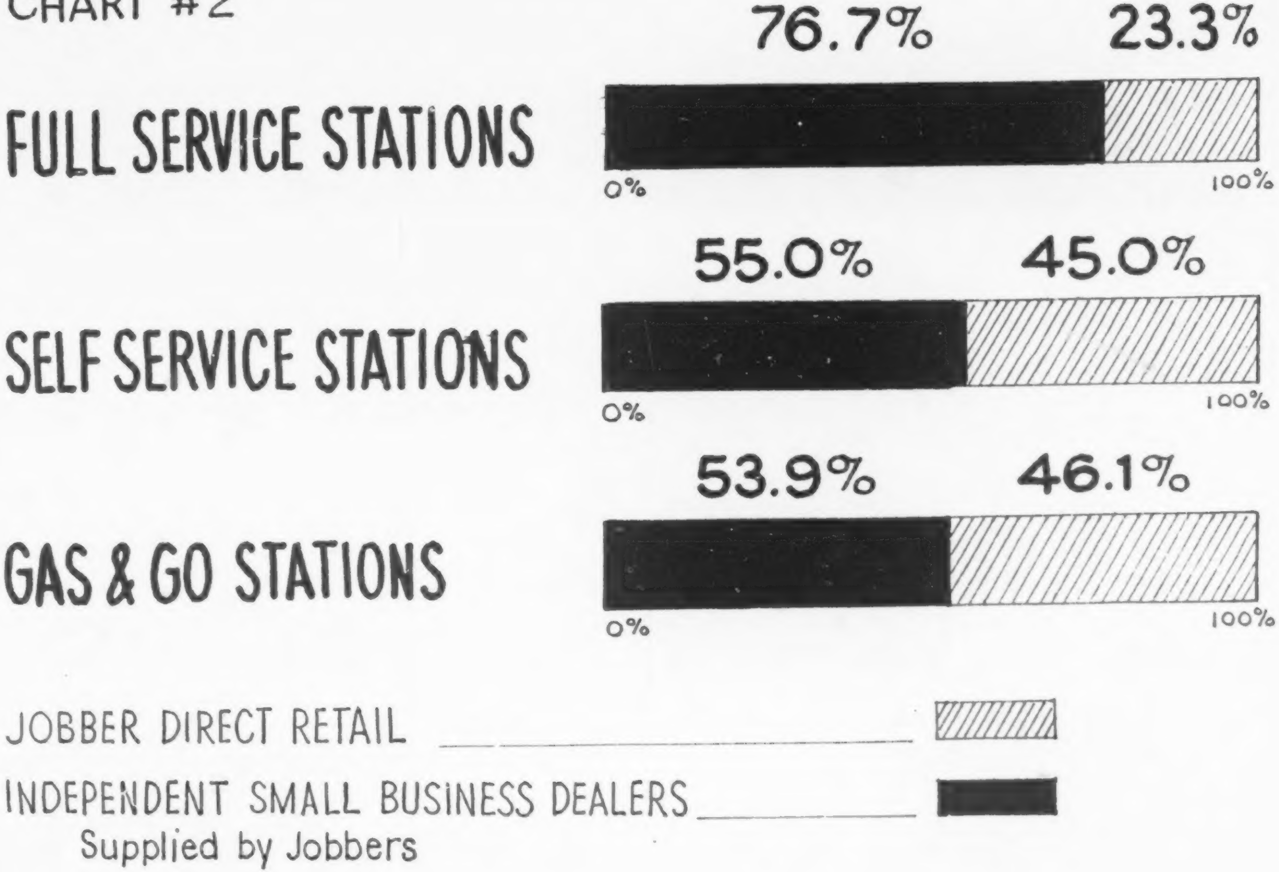

76.7%
23.3%
FULL SERVICE STATIONS
0%
100%
55.0%
45.0%
SELF SERVICE STATIONS
0%
100%
53.9%
46.1%
GAS & GO STATIONS
0%
100%
JOBBER DIRECT RETAIL ▨
INDEPENDENT SMALL BUSINESS DEALERS Supplied by Jobbers ■

CHART #3

DEALERS COMPETE WITH THEIR OWN SUPPLIER OUTLET, SAME PRODUCT, SAME BRAND, WITHIN 1/2 MI.

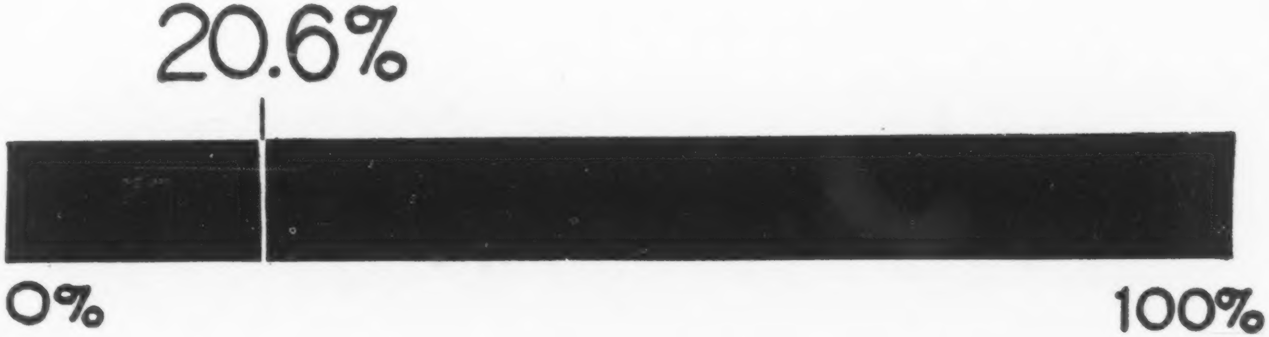
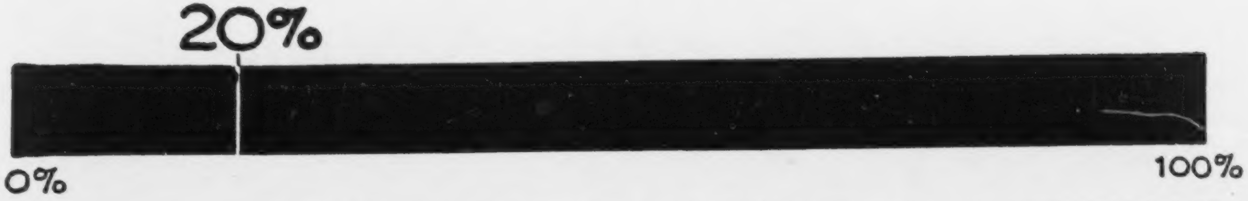


CHART #4

DEALERS TOLD THAT STATION WILL BE CLOSED AT THE END OF THEIR LEASE BECAUSE OF LOW VOLUME



DEALERS TO CLOSE AT THE END OF LEASE

16% LEASE FROM JOBBERS *84% LEASE FROM REFINERS*

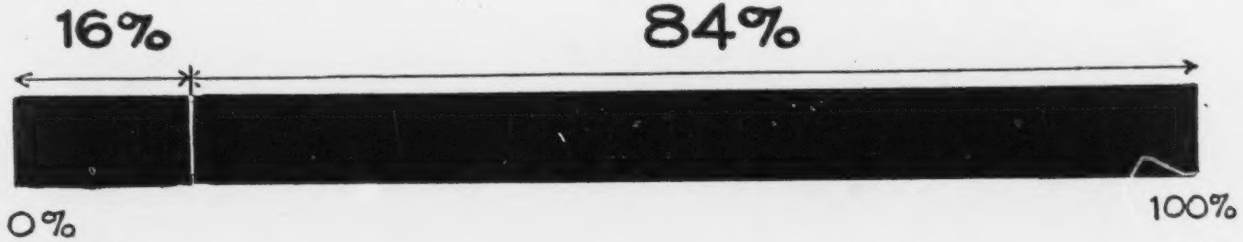
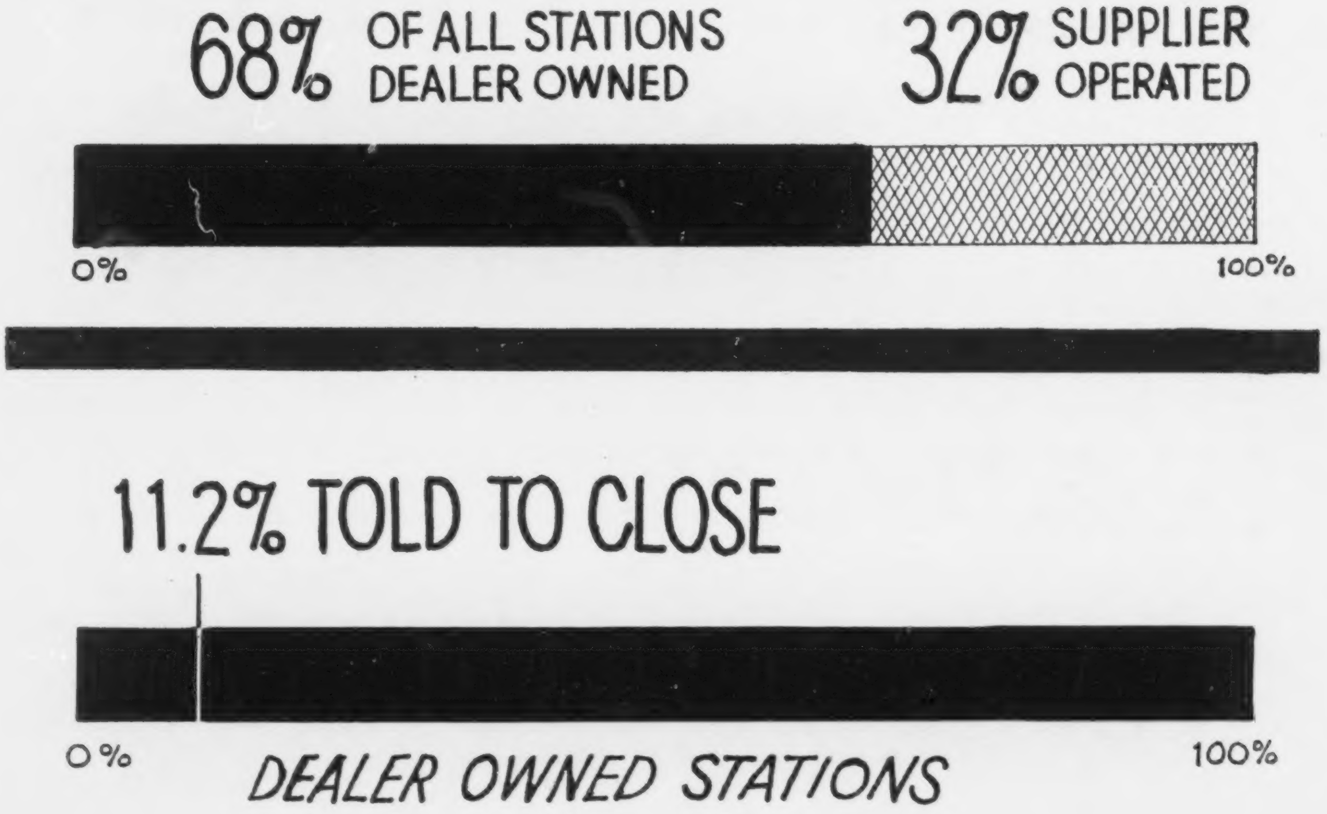


CHART #5


68% OF ALL STATIONS DEALER OWNED
32% SUPPLIER OPERATED
0%
100%
11.2% TOLD TO CLOSE
0%
100%
DEALER OWNED STATIONS

SSDA®
SERVICE STATION DEALERS OF AMERICA

RETAIL PRICE COMPARISON, REGULAR UNLEADED GASOLINE:: Before and after passage and implementation of Maryland Law to Divorce Refiners from operating retail gasoline outlets. (State, Federal & Local tax have been removed from the prices).

	1977	HIGHER (LOWER)	1981	HIGHER (LOWER)
MARYLAND	54.3¢	-	130.5¢	-
VIRGINIA	54.8¢	.5¢	133.7¢	3.2¢
WEST VIRGINIA	55.4¢	1.1¢	133.4¢	2.9¢
D. C.	62.1¢	7.8¢	134.7¢	4.2¢
DELAWARE	52.3¢	(2.0¢)	130.4¢	(.1¢)
PENNSYLVANIA	53.6¢	(.7¢)	126.3¢	(4.2¢)

*Prices were taken from AAA's National Surveys taken prior to each July 4th Holiday less actual taxes as obtained from appropriate authority of each state and D.C.

Prepared by: Jack W. Houston, Chairman
Government Affairs Committee
July, 1981

see 1977 through 1981 comparisons - back of this page

SERVICE STATION DEALERS OF AMERICA

UNLEADED GASOLINE/RETAIL PRICES* EXCLUDING TAXES

	1977	HIGHER (LOWER)	1978	HIGHER (LOWER)	1979	HIGHER (LOWER)	1980	HIGHER (LOWER)	1981	HIGHER (LOWER)
MARYLAND	54.3		56.9		77.6		115.5		130.5	
VIRGINIA	54.8	.5	54.4	(2.5)	75.8	(1.8)	113.5	(2.0)	133.7	3.2
WEST VIRGINIA	55.4	1.1	54.8	(2.1)	75.8	(1.8)	116.8	1.3	133.4	2.9
D. C.	62.1	7.8	64.1	7.2	84.2	6.6	120.4	4.9	134.7	4.2
DELAWARE	52.3	(2.0)	58.8	1.9	76.5	(1.1)	115.3	(.2)	130.4	(.1)
PENNSYLVANIA	53.6	(.7)	52.7	(4.2)	75.3	(2.3)	112.8	(2.7)	126.3	(4.2)

*FROM AAA'S NATIONAL SURVEYS- TAKEN PRIOR TO JULY 4TH HOLIDAY - EACH YEAR.

PREPARED STATEMENT OF TRACY L. STANTON

Mr. Chairman, Committee Members: The independent branded service station dealer is being priced out of the gasoline market today; not only by his particular brand supplier, but by all oil companies, collectively! Brand is of little importance in today's market, price is what sells gasoline today and it is price -- "The Wholesale Price" or "Dealer Tank Wagon" (DTW) Price -- that is putting people like me out of business, at the rate of some 34,000 service stations in the year of 1980 alone!!

I have listed the so-called wholesale price that independent branded dealers must pay for gasoline and compared that cost with the retail price advertised on the street by oil company operated gasoline stations. The prices listed are for regular grade gasoline, since it is traditionally used to market price, and they were current on Thursday, July 23, 1981 in Ohio.

Gasoline Price Comparison
Columbus, Ohio
July 20, 1981

Cost or DTW Independent Branded Dealer		Posted Retail Price Oil Company Operated Gasoline Stations	
Arco	$122.15	*Bonded	$119.9
Exxon	122.7	Clark	119.9
Gulf	123.4	*Hi-Val	120.9
Marathon	123.6	Hudson	121.9
Mobil	122.85	Kayo	120.9
Shell	122.6	Koch	121.9
Sohio	120.7, 125.7	Kocoline	119.9
Sunoco	122.6	*Omega	121.9
Union '76	123.7	Savemore	120.9
		*Sohio	121.9
		*Speedway	119.9
		*Stop N Go	122.9
		Thornton	120.9
		*Union '76	124.9

(*)Indicates that brand name dealers must try to compete in the same market area with company operations.

Comparison shows that oil company operated states are retailing gasoline for as much as 3.8¢ per gallon less than their own independent dealers are paying for the same product! No business of any type can compete or survive with that kind of disparity!! The habitual oil company solution to a dealer in financial trouble is "lower your retail price, pick up your gasoline volume, work on a 5¢ or 6¢ so-called margin and make your living from the greatly increased repair work you will realize due to the tremendous increase in your gas island traffic"! They do not have a solution to help the independent dealer who operates a "gas only" type outlet because the philosophy of give it away on the right and make it up on the left does not work when you have only product or service to offer.

What does this "gas only" dealer do? He tries different prices, different hours, less employees, and he goes broke!! Why? Simply because oil company operated gasoline stations are selling product as much as 3.8¢ below his cost!! He cannot compete!!

I speak with authority on this subject because I have been there. I have two service stations, one full service with repairs and one gasoline only. In today's market I cannot compete with $119.9 retail on the street when my cost for the same product is $122.6. My net profit at my gas only station since January 1, 1981 is $1,732.00 and this inability to compete has forced me to terminate my lease on this station.

There is another option: Mark up your product so you realize an acceptable profit on your business; then you put yourself in the position of my full service facility, when an independent branded dealer, like myself, sells his gasoline at a reasonable profit -- that being sixteen to twenty cents per gallon in today's economy -- he loses gasoline volume due to the unexplainable low street price of company stations. If that lost volume puts him in the 40,000 to 50,000 gallon per month bracket, then he faces lease nonrenewal because his location is no longer profitable to his parent oil company!

There are many more problems independent dealers face in the turmoil that exists in our industry today, but if we are not allowed to shop for the best price on our product, if we are forced to continue to try to compete with our landlord, supplier, and if the oil companies are allowed to continue their carefully planned monopoly of the petroleum industry, the independent branded service station is doomed. At the 1980 rate of 34,000 stations out of business, Big Oil will have it all within three years.

People with the small financial clout of the independent service station dealer obviously cannot win a confrontation with companies who filled thirteen of the top twenty pots in the Forbes 500" rateings for 1980! There are three things that will allow the independent service station to survive -- without them we will die.

1. Oil companies who refine gasoline must be prohibited from retail market operations.

2. All wholesale gasoline purchasers must be able to buy like product in like quantities for a like price from a common source on any given day.

3. Any gasoline retailer must be allowed to buy the same quality product from any supplier who offers the best price.

The independent service station dealer cannot attain these needs alone; so we ask the help of this Congress. When we attain retail divorcement, terminal wholesale pricing and open supply, then we will truly have real competition at all levels of sales and the ultimate benefactor will be the American consumer.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF PAUL F. ASHTON

Mr. Chairman and Members of the Committee:

My name is Paul F. Ashton. I am a lifetime resident of the State of Utah and reside in the community of Provo. I am the Association Dealer President of the Utah Petroleum Retailers Organization ("The PRO"). I operate as an independent petroleum dealer; I have two service stations in the Provo area--one a branded Chevron, the other a private-branded station. Like so many small businessmen across the country, I have everything I own invested with the many years I have put into these two stations. In spite of the many problems I face in my profession, it is seldom that you will find people such as myself appearing in a forum such as this one today. In fact, I believe that I may very well be the first Utah independent service station dealer to so appear. The reasons are really very simple. We are just that--independent, and traditionally we have worked to resolve our own problems and challenges internally.

However, today I am here to review for you a concern that neither my peers nor I can resolve by ourselves. That problem is caused by our suppliers, the refiners, moving forward into the retail gasoline marketplace. I'm aware that whenever this subject comes up, the refiners vehemently deny this charge. Nevertheless, in the State of Utah today, it is a fact of life. For a few minutes, I would like to review with you some of the marketplace facts in Utah today. Because of time restrictions, I will present the facts regarding only one refiner--Amoco. However, the problems in Utah are in no way limited to only Amoco.

In 1975, in the Salt Lake Valley alone, Amoco had fifty-three independently leased and/or independently owned branded Amoco locations in operation (see Exhibit 1, attached). During the years following, Amoco embarked on a program designed to get rid of the dealers and re-brand for company operation. The tactics used to displace these dealers were varied and brutal...and very effective. As you will note from Exhibit 2, the 1980 Salt Lake phone book lists only eight independent retailers remaining under the Amoco brand. Since that book was published, one of those eight has also been eliminated. Exhibit 2 also contains another page from the 1980 phone book, which lists Rainbo stations...the gasoline pumpers operated by the Amoco Oil Company. In the late 1970's, as Amoco began to wrap-up their "get rid of the dealers" program, they began to place on-stream these company operations. Exhibit 2 shows the twenty-two locations which have been introduced in the past few years. Of course, there have been changes since the phone book was published... several more Rainbo stations have been introduced during the last year.

Mr. Chairman, I put before you the often heard plea of the gasoline refiners concerning an alleged drop in market share and how they must change their marketing operations to address this problem. Consider--in Utah, Amoco forced the elimination of over 80% of its total Amoco-branded outlets. This elimination took place just prior to the placement of company-operated Rainbos back into the marketplace. Therefore, whatever market share Amoco had had previously would have to be drastically affected prior to the placement onstream of the company operations. This smokescreen of surprised concern regarding loss of market share was created by Amoco itself through the displacement of its dealers! Now, with the dealers eliminated, Amoco is going to the next step to try to convince anyone who will listen that by making this change in retail operations, they are able to regain their "lost" market position.

Mr. Chairman, Committee Members, if you believe that story, I have some old gold mine stock I'd like to discuss with you following this meeting.

I mentioned previously that the methods of dealer elimination in Utah were varied and brutal. I'd like to document for you one of the most brutal methods that has been and still is being used in the Utah marketplace today. Exhibit 3 contains this evidence. The photograph was taken on July 27, 1981. It is a photo of a Rainbo station operating on the same main thoroughfare as one of the few remaining independent Amoco dealers. Note that the Amoco-operated Rainbo station is pricing retail at $\$1.24^9$ for regular and $\$1.28^9$ for unleaded gasoline. On page 2 of Exhibit 3, note that the independent Amoco dealer's purchase price, before any consideration for rent payments he must make to Amoco in addition to the purchase price of the gasoline, is $\$1.24^7$ for regular and $1.28[7] for unleaded. In other words, this remaining independent dealer, who is contractually bound to purchase his gasoline from Amoco (who is also his street competitor), must purchase his gas wholesale at prices only two-tenths of a cent lower than his supplier is retailing gasoline down the street! Not two cents, but two-tenths of one cent.[8]

The effect of this type of condition is very simple. The independent retailer faces two choices, both bleak. If he holds his price up to try to make enough profit even to cover his expenses, he is going to begin to lose his customer base. If he lowers his price enough to compete with his supplier/competitor, Amoco, he is grossing no profit, is working for nothing, and is not producing the profitability to remain in business. In either case, the dealer reaches a point of financial exhaustion. He falls like a piece of ripe fruit from a tree; Amoco claims the location and either converts it to a Rainbo or sells the property, and then proudly proclaims that once more it has made another marketing stride to assist the motoring public while reclaiming its "lost" market share.

Mr. Chairman, I realize that there have been immensely time-consuming studies which claim that the refineries are not moving forward into the marketplace. I submit to you that the evidence I have shown you is in direct contrast to those claims. This evidence, which regards only Amoco, represents only a portion of the evidence gathered in Utah alone which can be presented to this committee to document the forward movement into the Utah marketplace of several other refiners.

As a small independent petroleum retailer, I plead with you to assist us by creating legislation which will prevent these conglomerate giants from placing independent petroleum retailers across this nation in positions that are totally untenable, therefore eliminating the small businessman from the petroleum business in America. Not only do I plead with you to do this, I believe that as our elected officials, you have an obligation to do this. I seek your help in this regard and thank you for affording me the opportunity to appear before you today.

PREPARED STATEMENT OF FRED C. ALLVINE

The issue before this committee is whether major brand dealers are subject to unfair and anti-competitive action from their landlord-suppliers and need new protection under the law. In the past I had opportunity to study problems of independent refiners and private brand marketers, and in more recent years to examine conditions being experienced by branded dealers. All of these downstream competitors are very vulnerable to the anti-competitive actions of the large integrated petroleum companies. Since the mid 1970s many major brand dealers have been subject to a variety of anti-competitive techniques designed to "economically evict" them from stations which they operate (see Allvine, Houston and Phillips Report dated February 1980).

Congress in passing the Petroleum Practice Act of 1978 mandated a study to examine the issue of economic eviction. The Office of Competition of the Department of Energy was assigned the responsibility for carrying out the subsidization study and as you are aware they came to the conclusion that the major petroleum companies "were not subsizing their marketing as part of a predatory campaign." The study which Congress mandated and the Office of Competition promised to conduct WAS NEVER CARRIED OUT. Congress mandate that the study, among other things, was to "examine the profitability of various segments of the petroleum industry" and to determine "the extent to which such subsidization is predatory and presents a threat to competition." The profitability of the "various segments" was not studied as mandated and promised by the head of the Office of Competition. Ignoring a great deal of readily available information about the profitability of the various segments, a theoretical study was designed that defined away the problem of subsidization. This seriously flawed study was then used to conclude that dealers were not confronted with anti-competitive practice that resulted in their economic eviction.

Enclosed is Chapter 5 of a monograph being prepared that deals with the anti-compettive nature of the operations of the large integrated petroleum companies. This chapter goes into detail explaining major flaws in the D.O.E. study. Drawing upon publically available information, evidence is presented supporting the conclusion that THE MAJOR PETROLEUM COMPANIES WERE SUBSIDING

THEIR MARKETING AS PART OF A PREDATORY CAMPAIGN. Without some form of legislative protection from anti-competitive behavior of their supplier - landlords, thousands of additionally branded dealers will be unfairly driven out of business.

Enclosure.

Chapter 5

ADDITIONAL INFORMATION ON THE ISSUE OF DOWNSTREAM SUBSIDIZATION FROM CRUDE OIL PROFITS

While the Federal Trade Commission in the United States and the Restrictive Trade Practices Commission in Canada were engaged in their investigations of the petroleum industries, another less extensive examination of the competitive behavior of the major integrated petroleum companies was initiated and completed. Congress mandated in Title III of the Petroleum Marketing Practices Act of 1978 that the Department of Energy "examine the extent to which producers, refiners and other suppliers of motor fuel subsidize the sale of such fuel at retail or wholesale with profits obtained from other operations" (emphasis added).

A primary conclusion of the D.O.E. inquiry was that "the major integrated petroleum companies were not subsidizing their marketing as part of a predatory campaign." This finding highly conflicts with the factual contentions in the F.T.C. suit and the conclusion of the Canadian Trade Practice investigation. The study of the D.O.E. vindicating the majors' marketing practices was enthusiastically received by the American Petroleum Institute and by the large integrated petroleum companies. In hearings and in speeches representatives of the integrated petroleum company often cite the "pro competitive" findings of the D.O.E. of the majors' marketing practices. Interestly, shortly after the study was issued, the director of the Office of Competition went to work with the law firm representing Texaco in the F.T.C. monopoly suit.

The Office of Competition held hearings to gather comments from interested parties before developing the final design for their "subsidization study." Many representatives from the downstream sector of the petroleum industry (i.e., independent refiners, small refiners, major brand jobbers, major brand dealers and independent private brand marketers) expressed guarded optimism over the prospect of a study carefully examining "marketing subsidization" since they felt that they had long been victimized by the practice (see October 1978 hearings of the Office of Competition of the D.O.E.). For example, the D.O.E. noted in reporting on the initial hearing that a representative of the Independent Refiners Association stated that "the subject of the present hearings represents potentially the most important government action in many years" and an author of this report stated at the same hearing that the "investigation has the potential for being one of the most important studies ever made of the petroleum industry."

Small wonder that there was great interest in this study since for more than 50 years complaints had been heard about "downstream subsidization" and its anti-competitive consequences. Consider the following statements from the first chapter of Part I of the Office of Competition Report (May 1980).

> The proposition that integrated petroleum companies subsidize their marketing operations is not new. Allegations of subsidization can be traced back to the late 1930's.
>
> * * * * *
>
> In 1936, the National Oil Marketers Association pushed for vertical divestiture on the grounds that it was unfair for independent marketers to compete against the marketing division of the major petroleum companies which did not have to show a profit.
>
> * * * * *

> In 1952, the South Carolina Jobbers Association asserted that competition in the marketing sector of the petroleum industry was unfair to non-integrated marketing companies unable to use profits derived elsewhere to underwite losses in marketing.
>
> * * * * *
>
> Melvin de Chazeau and Alfred Kahn writing in 1959 indicated that "excess capacity most especially among retail service stations, has long plagued gasoline distribution."
>
> * * * * *
>
> In 1965, the Federal Trade Commission (FTC) held extensive hearings on competition in the gasoline marketing industry...The accusation included the charge of price subsidization and of operating their marketing divisions without regard to its profitability...Nearly every participant claimed that the majors did not earn a reasonable return on their marketing network,...and perhaps not even a positive return.
>
> * * * * *
>
> Writing in 1972, Allvine and Patterson (stated): Anyone familiar with...gasoline marketing will admit that there are far too many stations...Normally, if market forces were allowed to work, the overcapacity would be eliminated. Those stations unable to earn a reasonable return would be closed...

The initial hearing on the subsidization study was followed by five field hearings in Atlanta, Boston, Fort Wayne, Houston and Los Angeles. Just as in Washington, these produced a litany of charges by downstream operators that the integrated petroleum companies were subsidizing their direct marketing operations (i.e., not covering full cost including a fair rate of return on capital investment) from crude oil profit. With the strong hearing record about "downstream subsidization" and its anti-competitive effect, it was hoped that at long last a definitive study would be carried out dealing with this problem. While there was general enthusiasm for the study, some speakers expressed concern that a poorly designed study would fail to recognize the problem. Jack Houston, representing branded marketers, even presented a petition at the Atlanta hearing calling for the chairman and his staff to resign since their actions seemed to indicate a bias against small business. The skeptics were correct and the study was a disaster. Evidence that filled the public record was ignored! The study of vertical integration and functional profitability mandated by Congress was not carried out! The D.O.E. report on subsidization was a great victory for the large integrated petroleum companies and a loss for the competitive process and the public interest.

DEFINING AWAY THE PROBLEM OF DOWNSTREAM SUBSIDIZATION

The D.O.E. in announcing its Study Plan for the Title III Report explained what the phenomenon of subsidization meant to "many observers" appearing at the initial October 1978 hearings.

> they believe that integrated petroleum companies "finance" low prices at the marketing stage through high profits at another stage of their operations. In other words, the low price and resultant low or negative profits of the vertically integrated companies' downstream operations are subsidized by their high (excessive) profits in upstream operations (crude oil exploration and production).

The above interpretation of subsidization is in fact frequently expressed and is a view held by downstream operators and one that is also consistent with what Congress had in mind in mandating the Title III subsidization study. Section 301B of the October hearing specifically stated that the study will examine:

(1) the role of vertically integrated operations in facilitating subsidization of sales of motor fuel at wholesale or retail;
(2) the extent to which such subsidization is predatory and presents a threat to competition;
(3) the profitability of various segments of the petroleum industry;
(4) the impact of prohibiting such subsidization on competitive viability of various segments of the petroleum industry, on prices

of motor fuel to consumers and on the health and structure of the petroleum industry as a whole; and

(5) such other matters as the Secretary considers appropriate.

Clearly, Congress envisioned that the D.O.E. would carefully examine "the role of vertical integration in facilitating subsidization" and would evaluate the profitability of the various segments of the petroleum industry. Nonetheless, the Office of Competition indicated that in its opinion the traditional definition of subsidization had some operational shortcomings. The study plan stated (at page 10) that "Although Title III requires us to analyze the profitability of these companies at various functional levels, the profits will not tell the whole story (emphasis added)... Because of these problems, the Office of Competition has decided not to rely exclusively on differentials in functional profits to determine subsidization" (at page 11). However, the Office of Competition did not merely supplement the prescribed examination of "differential in functional profitability" with its own study design for measuring subsidization. It actually supplanted the mandated approach to studying subsidization with its own approach. Unfortunately, the methodology adopted for the study had a critical deficiency which invalidated the conclusion that the large integrated petroleum companies were not subsidizing their marketing as part of a predatory campaign.

As will be demonstrated later in the chapter, the analysis of functional profitability certainly supports a finding of extensive and long standing downstream subsidization of marketing and refining from crude oil. A serious question that needs to be considered is "Why didn't the Office of Competition carry out the mandated analysis of functional profitability?" If the functional profitability analysis had been completed it would have contradicted the conclusion of no subsidization reached by the Office of Competition.

The Office of Competition not only failed to carry out the mandated study, but was not completely honest in explaining the alternative approach that it planned to use to measure subsidization. The Study Plan simply stated that "cost which can be directly attributable to marketing operations" would be subtracted from the "retail price charged by the majors" to determine "the effective transfer price". The subsidization hypothesis was to be rejected if the "adjusted pump price" was "above the commodity price." "If the adjusted pump price of the integrated company is below the price at which the company can sell its products to wholesalers or chain retailers, the hypothesis that integrated companies subsidize their retail operations cannot be rejected." As described above, the procedure designed to measure subsidization by the D.O.E. staff appeared to be an approach that could well compliment the mandated analysis of functional profitability of the integrated petroleum companies.

Given the historical basis of the subsidization problem, the extensive hearing record on the issues and other secondary sources of information indicating downstream subsidization, the finding of the D.O.E. of no anti-competitive subsidization of marketing by the integrated petroleum companies came as quite a surprise. The answer to the question of how the D.O.E. could reach such a conclusion was contained in the final methodology adopted by its staff economists. In reporting their conclusion (see Part I: The State of Competition in the Gasoline Industry), they explained that a "netback method" had been employed to measure subsidization which only took into account some of the marketing costs, but not all of the cost properly attributable to marketing. As explained "the netback is simply the average selling price for gasoline minus the incremental marketing expenses associated with gasoline sales through company-operated retail outlets"... (emphasis added). "If the netback is less than the appropriate wholesale price,..., then subsidization may be taking place. Conversely, if the netback is greater than the appropriate wholesale price, then subsidization is not occurring." The Office equated "incremental marketing expenses" to "variable cost" and concluded that if the netback covered variable cost then there was no predatory subsidization. The methodology adopted excluded fixed cost and capital cost which are all costs "directly attributual to...marketing operations" (as stated in the Study Plan).

The authors of the D.O.E. report adopted the Areeda-Turner proposition which in essence states that when prices do not cover short-run variable costs there exists prima facia evidence of predation. If one is only talking about a matter of a few months (i.e. 3 months or less), then perhaps the variable costs used in the analysis are appropriate, since they are the only costs that can immediately be avoided by shutting down the operation. However, since the analysis covered an entire year, the appropriate cost items include the entire retail outlet and accompanying overhead costs. Over this longer time period the retail outlet can either be sold or leased and the corporate expenditure can be cut and staff laid off. What the staff of the Office of Competition did was to inappropriately adopt a measure of short-run variable cost for evaluating a whole years' performance.

Furthermore, it should be understood that the Areeda Turner proposition is a very extreme test which states that in the short-run, if variable costs are not covered, one has a per se violation. In other words, Areeda Turner does not rule out the possibility of predation existing even if prices are high enough to cover variable cost, but are lower than needed to cover average total costs. Thus, the economists in the Office of Competition further misconstrued the Areeda Turner proposition as being the basis for rejection of predation which it is not. Another problem with the procedure used is that the Areeda-Turner test applies only to individual outlets, and not to the average netback for all sampled company outlets. If a company is engaging in predation as a matter of policy, then there will be some stations that have predated in the past and that now have high prices. Therefore, when you take averages you are getting a mixture of high and low prices and predation on an individual station basis is not measured as it should be. In essence what the Office of Competition did was to measure whether a company was engaged in predation in all stations for an entire year. Just as the average netback gives a meaningless number, using a whole year to test for predation is illogical. It assumes that a firm couldn't predate for say six months, drive a competitor out, and then increase prices.

There is still another important flaw in the Office of Competition methodology. Since they chose to include only short-run, retail related, costs in their calculation, they should have compared the "netback" to the higher dealer tankwagon price instead of the lower wholesale commodity price. The dealer tankwagon price with a rent factor included is approximately six cents per gallon greater than the commodity price. The best price alternative (i.e. the opportunity cost) to selling the gasoline at the company operated stations is selling it through the petroleum company's own dealer operated stations. Furthermore, this would be advantageous since costs such as regional management, advertising and sales promotion expenditure, service station costs, etc., do not have to be estimated because these items are presumably included in the dealer tankwagon price. Had the "netback" been calculated using the (higher) dealer tankwagon price, it would have been negative, supporting the conclusion of "predatory" subsidization. Criticism of the netback methodology used not only came from downstream operators, but also from American Oil Company. In responding to the netback calculation procedure Amoco stated that it "... does not include a charge for capital investment. As others have commented, we believe this should be included" (see appendix of Final Report).

FUNCTIONAL PROFITABILITY ANALYSIS

The Study Plan stated that not only had Congress mandated an analysis of "the profitability of various segments of the petroleum industry," but also that many statements at the initial "October 6-7, 1978 hearing focused entirely on functional profitability." The Study Plan stated that "an integral part of the Title III Study will be a computation of upstream-downstream profit comparisons." The authors of the Study Plan even went on to explain that "Profitability can be viewed as an indicator of monopoly power if it remains persistently high over a relatively long time span. Likewise, a differential between upstream and downstream profit rates must be present over a sufficient span of time to indicate the possibility of subsidization" (all of the above quotes come from page 20 of the Study Plan).

Furthermore, Bill Lane, Director of the Study, testified under oath at the October 11, 1979 hearings of the House Small Business Subcommittee on the prevalancy of downstream subsidization that:

> We have testimony at hearings, we have talked...with...over 100 people in the industry; we have done a lot of reading, we have looked at subpoenaed documents, and the conclusion is fairly inescapable that during the 50's and the 60's, there was a substantial degree of subsidization of marketing...

He further testified on May 20, 1980, that "functional profitability" would be examined in Part II of the study. When the Final Report (January 1981) was issued it was discovered that the long awaited and mandated study of "functional profitability" was not carried out. Instead, the Final Report stated that "any analysis of functional profitability is deferred to the Financial Reporting System which possesses a large data base that may be better able to address the issue." This is the same division of the D.O.E. that Reagan recommended for zero budget.

The Office of Competition could easily have carried out the functional profitability analysis and presented data for the entire 1970 period. This information would show that downstream subsidization did not cease in the early 1970s as the Lane testimony indicated, but that downstream subsidization continues on to the present. For some reason the Office put major stock in reports of several petroleum companies in the early 1970's suggesting that they were no longer going to subsidize refining and marketing, but were at long last going to force these activities to stand on their own. However, this was not the first time the petroleum companies had focused on the limited profitability of marketing and vowed to do something about it. Then, as now, the urgency to the petroleum companies to do something about their subsidized downstream operations diminished, and the anticompetitive practice continued. The D.O.E. Report presented a quote from a 1972 management study from a large petroleum company which was considered to be "illustrative and typical" of the petroleum companies' position at the time (see the Final Report, Book II, page 14):

> The first discernible trend (forcing a reconsideration of past policies) was the decline in investment opportunity in domestic production... as our opportunity for new production facilities diminishes -- so do our investment opportunities -- that means a decline in our return.

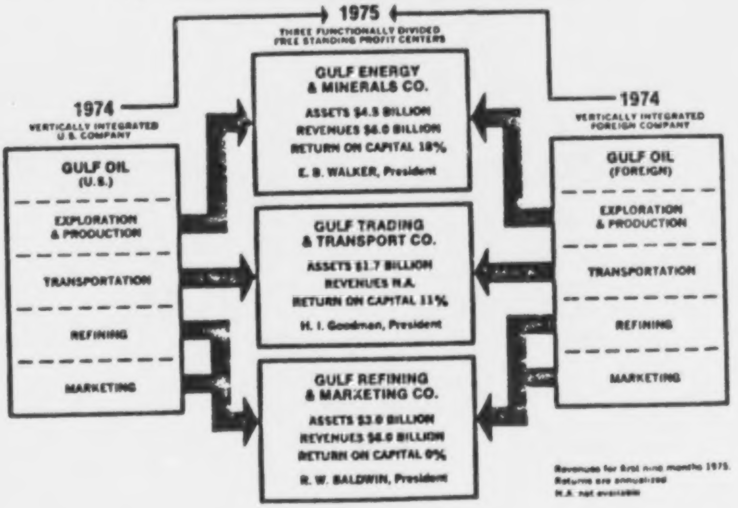
However, a footnote to the above statement indicated that "This comment was written in 1972 before the tripling of crude oil prices in 1973." Furthermore, since the 1972 report was made the domestic price of crude oil has increased approximately ten fold making the investment opportunity in crude oil extremely atractive. Since the D.O.E. recognized that the pressure to improve the profitability of marketing had greatly diminished, why did they put so much stock in statements made in the early 1970s about the need to cease the practice of downstream subsidization.

As Lane testified there is a great deal of information documenting the subsidization of refining and marketing from crude oil in the 1950's and 1960's. The major petroleum industry trade journals (The Oil and Gas Journal, The National Petroleum News and The Oil Daily) and primary business magazines and newspapers (Business Week, Forbes and the Wall Street Journal) have all had articles commenting on the practice of downstream subsidization. Management reports and government studies similarly document the low profitability of refining and marketing and their subsidization from crude oil in the 1960's and into the early 1970's (see Allvine and Patterson, Highway Robbery, 1974, pages 61-66). But the evidence of downstream subsidization doesn't stop in the early 1970's as the Final Report of the D.O.E. suggests. For example consider the following:

> In 1975 Gulf earned nothing from the $3.0 billion investment in refining and marketing while earning 18 percent on its $4.5 billion dollar investment in production (see attached diagram) [Forbes, January 15, 1976, and Gulf Financial statement for 1976].

Smart Management? Or Preparing For The Inevitable?

Now Gulf Oil—and several other firms—are restructuring their oil operations. The goal: to raise rates of return on refining and marketing. Such an organization would also cushion the shock if Congress breaks up the industry.


1975
THREE FUNCTIONALLY DIVIDED FREE STANDING PROFIT CENTERS
1974
VERTICALLY INTEGRATED U.S. COMPANY
GULF OIL (U.S.)
EXPLORATION & PRODUCTION
TRANSPORTATION
REFINING
MARKETING
GULF ENERGY & MINERALS CO.
ASSETS $4.5 BILLION
REVENUES $6.0 BILLION
RETURN ON CAPITAL 18%
E. B. WALKER, President
GULF TRADING & TRANSPORT CO.
ASSETS $1.7 BILLION
REVENUES N.A.
RETURN ON CAPITAL 11%
H. I. Goodman, President
GULF REFINING & MARKETING CO.
ASSETS $3.0 BILLION
REVENUES $6.0 BILLION
RETURN ON CAPITAL 0%
R. W. BALDWIN, President
1974
VERTICALLY INTEGRATED FOREIGN COMPANY
GULF OIL (FOREIGN)
EXPLORATION & PRODUCTION
TRANSPORTATION
REFINING
MARKETING
Revenues for first nine months 1975.
Returns are annualized
N.A. not available

In 1975 Continental Oil Company earned only 2.5 percent return on its U.S. refining, marketing and transportation in contrast with 20.4 percent from petroleum production. In 1976, Continental earned 6.8 percent from its downstream investment and 19.6 percent from production [Continental Oil Company 1976 Annual Report].

After "a turnaround in refining and marketing performance" in 1976, Sun Oil Company earned only a 7.7 percent return from its investment. In contrast, a similar investment in petroleum production earned a 25.2 percent return [Sun Oil Company 1976 Report].

"The refining, supply, and marketing segments of Phillips business performed better in 1976 than in 1975 when this area was unprofitable" [The Oil Daily, March 25, 1977, p. 15].

"For a year and a half, we (Mobil Oil Company) have been losing money on the over $2 billion of marketing and refining assets we have here in the United States." [Source: Statement of Mobil Oil Company to Senate Committee on Government Operations and Commerce Committee, July 1975].

Exxon had more than $2.25 billion invested in refining and marketing in 1974 on which it had earned a .5 percent return. This is in contrast to a return of 18 percent for overall operations. [Source: Wall Street Journal, August 27, 1975, and Joint Senate Hearings, July 17, 1974].

From the front page of the Wall Street Journal came the following report: " ... gasoline for decades has been something of a 'loss leader' for the oil giants. Their refining and marketing operation--'downstream' operations, as they are known in the industry--have often been big money losers.

'Upstream' Profits:

This status was partly by design because the companies made their biggest profits 'upstream'--that is, in the production of crude oil. To keep the profitable crude oil flowing, the companies were eager to refine and market large volumes of petroleum products, mainly gasoline, even if it meant selling the products at little or no profit or at a loss.

> Top officers of the major companies don't like to talk about this system. But insiders confirm that the companies in effect, were using refining and marketing as an elaborate disposal system that was subsidized with the profits the companies took at the wellhead. [Source: Peter B. Roche, "Pumping Up Profts," Wall Street Journal, Marcy 28, 1977, p. 1.]

The practice of downstream subsidization continues to the present. For example, Exxon only earned 4.3 percent from refining in marketing in the United States in 1970 and 4.0 percent in 1979 (see Exxon's 1979 Annual Report). Similarly, Standard of Indiana (i.e. Amoco), which is considered by many to be a primiere gasoline marketer, reported a return on identifiable downstream assets of only 1.3 percent in 1979 (a good year for marketing) and .8 percent in 1980 (see 1980 financial statement). Finally, in the fourth quarter of 1980 and the first quarter of 1981 several companies such as Exxon, Socal, Phillips and Continental reported losing money, or barely breaking even in their downstream operations.

The Office of Competition stated that when (more correctly "if") the functional profitability study was conducted several years of data should be used to discern whether this "indicator of monopoly power" persists "over a relatively long time span." It was further noted that "a differential between

Table 1

ANALYSIS OF FUNCTIONAL PROFITABILITY
OF 18 PETROLEUM COMPANIES FROM 1970 - 1974
(thousands omitted)

A. Exploration and Production

	1970	1971	1972	1973	1974	Average
Pre-tax earnings	$ 3,292	$ 3,699	$ 3,874	$ 4,440	$ 7,530	
Net investment	15,300	15,300	16,200	18,000	22,000	
Rate of return	21.5%	24.2%	23.9%	24.7%	34.2%	25.7%

B. Downstream-Refining, Marketing and Transportation

	1970	1971	1972	1977	1974	Average
Pre-tax earnings	$ 1,274	$ 574	$ 474	$ 761	$ 851	
Net investment	22,707	24,112	24,349	24,848	27,541	
Rate of return	5.6%	2.4%	2.0%	3.1%	3.1%	3.2%

Table 2

ANALYSIS OF FUNCTIONAL PROFITABILITY
OF 8 PETROLEUM COMPANIES FROM 1975 - 1980*
(thousands omitted)

A. Exploration and Production

	1975	1976	1977	1978	1979	1980	Average
Earnings	$ 2,149	$ 5,110	$ 5,843	$ 8,523	$12,065	$17,137	
Assets	7,661	17,071	21,697	36,254	44,418	46,113	
Rate of return	28.1%	29.9%	26.9%	23.5%	27.2%	37.2%	28.8%

B. Refining, Marketing and Transportation

	1975	1976	1977	1978	1979	1980	Average
Earnings	$ 74	$ 1,137	$ 1,581	$ 2,454	$ 2,930	$ 2,887	
Assets	11,091	18,058	19,976	24,598	27,682	23,440	
Rate of return	0.7%	6.3%	7.9%	10.0%	10.6%	12.3%	8.0%

*See Appendix B for detail information.

upstream and downstream profit rates must be present over a sufficient span of time to indicate the possibility of subsidization (and) ... We believe 10 years is the most reasonable span" (of time to consider). Since the D.O.E. never got around to conducting the subsidization study, the authors of this report using public available information, have carried out an analysis of functional profitability covering the period from 1970 through 1980. The data from 1970 through 1974 comes from an "unpublished report" of John Phelps who was an economist in the financial analysis division of the D.O.E. This data covering 18 integrated petroleum companies was derived from a variety of government reports. Functional profitability information for the years 1975–1980 came from annual financial reports and 10K's of eight major integrated petroleum companies. Unfortunately, several large petroleum companies (e.g. Mobil, Texaco, Socal, and Marathon) did not report their profitability in a manner that a functional analysis could be performed. The functional profitability analysis carried out by Phelps is presented in Table 1. For the five year period from 1970 through 1974, the before tax return on investment averaged 25.7 percent of crude oil, while for downstream activities including pipelines, refining and marketing it was only 3.2 percent. Data covering the years 1975 through 1980 is shown in Table II. Similarly, the before tax return on investment averaged 28.8 percent for crude oil while it was only 8.0 percent for the downstream functions including pipelines, refining and marketing. The data clearly shows that high excessive returns has been regulary made from crude oil production; while a low and noncompetitive rate of return has been earned from refining and marketing.

The data on functional profitability from 1970–1980 definitely is suggestive of a high degree of downstream subsidization of refining and marketing from crude oil. It is also consistent with Lane's "inescapable conclusion" of there being substantial subsidization downstream during the 1950s and 1960s. Had the Office of Competition of the D.O.E. carried out the mandate study of functional profitability, it would have found substantial evidence of MONOPOLY POWER BEING DERIVED FROM VERTICAL INTEGRATION. Furthermore, had the D.O.E.'s "netback" analysis been properly executed, it would have presented data supporting the hypothesis that the major petroleum companies "WERE ~~NOT~~ SUBSIDIZING THEIR MARKETING AS PART OF A PREDATORY CAMPAIGN."

The CHAIRMAN. The last two panels will come up together.

We have Henry C. Turner, Jr., senior vice president of National Oil Jobbers Council, Salisbury, N.C.; Tom Fuller, president of S.C. Oil Jobbers Association of Spartanburg, S.C.; R. Timothy Columbus, Society of Independent Gasoline Marketers of America; and Jack A. Blum, Independent Gasoline Marketers Council.

Mr. Houston, I have one more question to ask you. I will wait until this panel is through and then call you back for just a moment.

We have 30 minutes left, gentlemen, to finish this hearing.

What we would like to do would be to give each of you about 5 minutes to summarize your statements. We will put your entire statements into the record at the completion of the oral presentation of the panel.

That will give us 10 minutes for questions if that is agreeable with you.

Is that agreeable with you, gentlemen?

Who will go first?

Mr. TURNER. I am next on the agenda, Mr. Chairman, so I will go next.

The CHAIRMAN. Mr. Turner, are you for or against this bill?

Mr. TURNER. I am opposed to the bill, sir.

The CHAIRMAN. Are you a jobber?

Mr. TURNER. Yes, sir.

The CHAIRMAN. Mr. Fuller, are you opposed to the bill?

Mr. FULLER. Yes, sir. Opposed.

The CHAIRMAN. Mr. Columbus, are you opposed to the bill?

Mr. COLUMBUS. Yes, sir. The society opposes this legislation.

The CHAIRMAN. Mr. Blum, are you opposed to the bill?

Mr. BLUM. The Independent Gasoline Marketers Council is opposed to the legislation.

The CHAIRMAN. All four of you are opposed to the bill.

If that is agreeable then, we will take 5 minutes each.

STATEMENT OF HENRY C. TURNER, JR., SENIOR VICE PRESIDENT, THE NATIONAL OIL JOBBERS COUNCIL, WASHINGTON, D.C.

Mr. TURNER. I will summarize my statement, Mr. Chairman, and try not to take 5 minutes.

My name is Henry C. Turner, Jr., and I am president of Turner Oil Co., an independent petroleum marketer marketing petroleum products in Salisbury, N.C.

I am here representing the National Oil Jobbers Council, a federation of 47 State and regional trade associations which represent approximately 22,000 independent small businessmen who are petroleum marketers.

We estimate that these companies market more than 50 percent of the gasoline and 85 percent of the residential home heating oil sold in America today.

I am pleased to provide the committee with NOJC's position on S. 326, a bill which would divorce certain refiners and establish a wholesale transfer price mechanism.

One of the great problems facing small gasoline marketers is the ability of refiners to use upstream production and refining profit centers to subsidize their direct retail marketing operations.

In addition to predatory pricing and supply practices by integrated refiners engaged in the dual distribution, there are other refiner practices which adversely affect independent marketers.

These more subtle forms of subsidization which the Department of Energy title III report on subsidization chose to ignore include the elimination of jobber prompt payment discounts, hauling allowances, and so forth.

In addition, the refiners' adherence to strict credit limits mandates that an independent lower his volumes as the price of product rises.

Today another problem is plaguing marketers. Most of our members buy under contract from their suppliers. Now that there is a surplus of product, many refiners are offering rebates of various cents per gallon for purchases only on the volumes purchased above a base level.

At the same time these refiners are offering product to noncontract purchasers on the so-called spot market at prices as much as 10 to 12 cents cheaper, according to published reports, with no mandated minimum purchase.

In other words, marketers can purchase motor gasoline at a lower price from refiners with whom they have no contract than they can from a refiner with whom they have a contract.

In several instances, jobbers have been notified of a refiner's intent to terminate their contract because they have not purchased minimum monthly volumes.

We find these pressure tactics to be unfair. A simple price reduction rather than complicated rebate schemes for contract jobbers would enable independent marketers to sell more competitively and allow the motoring public a more reasonable price at the pump.

The continuation of these complicated rebate schemes in the face of shrinking demand raises questions as to the rationale for these ill-advised programs. Perhaps these schemes are merely being used to terminate those jobbers which a refiner no longer wishes to serve while remaining within the verbage of the Petroleum Marketing Practices Act.

We consider such tactics predatory, anticompetitive, and inflationary.

The petroleum industry has just entered into the post-decontrol environment. The full impact of the administration's decision has not yet been experienced. It may be some period of time before jobbers are in a position to evaluate the full impact of decontrol and its repercussions on refiner subsidization.

To legislate a solution to marketing problems during this transition period is premature. The marketplace must be given the opportunity to recover from the years of regulation and resolve the problems it can. If old problems persist or new problems develop, then we should look at legislative solutions.

Unfortunately, the legislation before this committee does not adequately address the problems.

The most troubling section of the legislation for our members is the wholesale transfer pricing section. If enacted, this legislation could potentially lead to the demise of approximately 25,000 independent lessee dealers served by jobbers and certainly have a negative impact on another 38,000 open dealer retail outlets served by jobbers.

As written, the legislation requires each supplier to post a single daily wholesale transfer price for each type of motor fuel. This transfer price will be the price to each purchaser of motor fuel that day.

The impact of this provision is to virtually eliminate the wholesale function entirely.

The Chairman. Mr. Turner, your 5 minutes are up.

Mr. Turner. Thank you, sir.

The Chairman. Mr. Fuller, we will put your entire statement in the record or you can go as far as you can in 5 minutes, and then we will put the rest of it in. We will put it all in or however you would prefer to have it done.

STATEMENT OF TOM FULLER, PRESIDENT, SOUTH CAROLINA OIL JOBBERS ASSOCIATION, SPARTANBURG, S.C.

Mr. Fuller. My name is Tom Fuller. I am president of Service Oil Co. in Spartanburg.

I would like to make a statement. We have a statement and an addendum that we would like inserted into the record in addition to the oral comments, please.

The Chairman. Your entire statement will go into the record. If you do that, I wish you would not read your statement, because we will have that in the record.

Offhand tell me why you oppose this bill.

Mr. **Fuller**. I will skip over the high points.

I am the president of the South Carolina Oil Jobbers Association. Our board of directors, which is the governing body of our organization, every time this bill has come up has opposed it, primarily for one reason. We feel it is anticompetitive.

We have many reasons why we feel this. First of all, we do not think that the industry should be restructured to take care of a few ills in the industry; and we know that there are some ills. We hope that we will be able to solve them without legislation.

Our problem right now is that all of us—dealers, jobbers, and major oil companies—have suffered through 10 years of too much Government in our businesses right now. We finally got them out. Hopefully, we can solve our problems internally without having legislation to do this.

We oppose the divorcement bill because we just do not think it is the proper thing to do.

The 16 top people we are talking about should be allowed to compete. We think anybody should be allowed to compete—ourselves included.

Under the present situation with no controls in effect, there is no reason why a dealer cannot become a jobber if he wants to. There is no reason why a jobber cannot become a refiner if he wants to if he has the money and the expertise to do so.

If the controls are gone, that opens things up a whole lot.

JOBBERS ARE REAL TARGETS OF DIVORCEMENT

One thing that interested me very much was something Mr. Allvine said. I would like to quote a statement that he made in 1978 to the Georgia Independent Oil Marketers Association. He was talking about the Maryland-style divorcement bill. He said:

> To a very large extent it is class legislation designed to protect the branded dealers from changes occurring in the marketplace. We all know that there are far too many major brand stations to efficiently serve the needs of the public. Dealer organizations are attempting to slow the badly needed attrition of major brand stations. Furthermore, marketing divorcement will reduce the growth of gasoline convenience store operations, which is winning increasing public acceptance. Marketing divorcement legislation is clearly not in the public interest.

This is a quotation from Dr. Allvine who is the same gentleman who appeared here last year and again today in favor of marketing divorcement, which he says was not in the public interest.

We have had a lot of casualties in the dealer area population, and we are going to have some more.

Part of the reason for this is the overbuilding of service stations. Part of it is the slowness of dealers to respond to the market changing conditions. Part of it is their inability to obtain financing in today's high market.

Now they are trying to include the jobbers in it. We are in the wholesale business. We are in the retail business. We are in both businesses. We have to be. We are like they are; we are strapped for money, and we have to do what we can to make it.

I wish I had a little bit more time. Apparently, I am getting to the end of my 5 minutes.

I would like to respond to what is going to happen if this bill is passed.

In my addendum there is an exhibit A and an exhibit B, which will give you some indication of what we feel will happen if this is done.

BIG PROBLEM IS PREDATORY PRICING

The National Oil Jobbers Council is presently considering something to solve it. We think the big problem is predatory pricing practices.

The National Oil Jobbers Council is presently taking under study some things that we think can solve this problem without S. 326. We do not think that is necessary.

Senator Metzenbaum's aide may be interested in this. There were some questions he raised.

One is talking about the opportunity for a dealer to do something in court. You might be interested to know that in South Carolina, we had a Gulf dealer who was just awarded $1.5 million because of a termination proceeding. We would be happy to give you further information on that if you are interested.

The other question was about rents that have been raised. That is true, but primarily they are economic rents that have been raised. For years the dealers have been renting stations for ½ cent to 2 cents per gallon which is not economic. Most of these rents are raised based on outside real estate appraisals and not just because the company decides that they want to raise the rent.

You might also be interested to know, on consumerism—and here, again, Senator Metzenbaum is not here, but he was talking about the prices in California as compared to Ohio and Washington, D.C., and so forth.

I am not that familiar with this, but to the best of my knowledge Sohio is one of the biggest marketers in Ohio. To my knowledge, most of their stations in Ohio are company-operated stations. That is pretty well consumerized I think.

The CHAIRMAN. Mr. Fuller, your time is up.

Mr. FULLER. Could I make one more point?

The CHAIRMAN. It will come out of somebody else's time, but go ahead.

Mr. FULLER. Senator Bedell was comparing gasoline prices in Maryland with the District of Columbia and asked you to drive down and take a look. You might also consider that the taxes, the cost of land, and the cost of labor are considerably higher in Washington, D.C., than they are in the Chesapeake Bay area. Hotel rooms in Washington, D.C. are higher than they are in Spartanburg, S.C.; yet it is the same size room. [Laughter.]

I thank you, sir.

The CHAIRMAN. Thank you.

Mr. Columbus is our next witness.

STATEMENT OF R. TIMOTHY COLUMBUS, SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA, WASHINGTON, D.C.

Mr. COLUMBUS. I will be very brief, and I will submit my statement for the record.

The CHAIRMAN. You want your entire statement put in the record?

Mr. COLUMBUS. Yes.

The CHAIRMAN. If you can briefly summarize it in about 3 minutes, we are running behind.

Mr. COLUMBUS. I will do it, Senator.

The society opposes this legislation basically for two reasons. First of all, we believe the divorcement provision in this legislation represents an unnecessary intrusion into the marketplace by the Federal Government. That kind of intrusion, which we consider to be a very radical intrusion into the marketplace, could only be justified, in our view, upon a showing of predatory pricing practices, subsidization, and whatever. When I say a showing, I mean a concrete showing, Mr. Chairman. We do not believe that showing has been made.

Moreover, having taken experience from the States, this appears to us to be a first step in something that will ultimately include us.

Mr. Chairman, I would recommend that you take a look at what has happened, particularly in the Northeast in the State of Connecticut and the State of Maine.

In fact, this spring in Maine, dealer-sponsored legislation was introduced which would have prohibited anyone from operating more than six retail outlets in the State of Maine. We feel that is very, very anticonsumer.

SIGMA's members are in fact private brand retailers. With respect to their suppliers, they stand in the same position as branded dealers. SIGMA views this legislation as class legislation designed to protect a particular segment of the market.

We believe that with respect to the pricing provisions of this legislation, it would be a major error to pursue them.

Specifically, we have just come out of 8 years of intensive price controls. I do not have to remind you that right up to the end of that program, DOE was still fine-tuning it.

It is a cause of great concern to us to have a new pricing mechanism for the petroleum market legislated. It is hard enough to get something fixed in the administrative process. It is 10 times that hard to make an adjustment in a piece of legislation.

In conclusion, while SIGMA's members are small businessmen in the context of the petroleum industry, and they certainly appreciate the concern expressed by you and the other Members of Congress, we believe that this legislation represents the wrong answers to the wrong questions.

SIGMA is dismayed by representations made to you that the answer to encouraging competition in the retail market is, in fact, to limit it. We, therefore, urge this committee not to approve and report out S. 326.

The CHAIRMAN. Thank you.

Mr. Blum is the next witness.

STATEMENT OF JACK A. BLUM, GENERAL COUNSEL, INDEPENDENT GASOLINE MARKETERS COUNCIL, WASHINGTON, D.C.

Mr. BLUM. Thank you, Senator.

I have submitted my statement for the record. I will attempt to summarize it.

The CHAIRMAN. Without objection, your full statement will be put in the record.

Mr. BLUM. Thank you.

Our association is composed of large chain retailers who operate under their own brand names.

I brought along a chart today that shows the system of gasoline distribution in the United States and shows how complicated it is. You probably could add some more blocks to it for different types of retailers.

The salient point is that only one type of retailer wants this bill. That type is the branded lessee dealer who leases from his major refiner-supplier. Everyone else on that list does not want this bill, because they feel they would be competitively disadvantaged. Our people are certainly in that category.

You have to understand why.

As this bill is structured, we fear it would end the ability of our members to get refiners to bargain with each other and with our members over price. Our people go out and shop for the lowest-priced gasoline at the wholesale level. They do it, because they invested in their own stations. They have their own businesses. They go to the supplier with the lowest price.

The lessee dealer cannot do that, because he signed a contract that said he would only buy from one supplier. That was his choice, and that is his business.

Now he wants to have Congress change that. He wants it set up so that the contract he signed does not bind him. He wants to be able to keep our ability to bargain down by preventing refiners from lowering prices when we put pressure on them. He wants to be given parity.

I do not see why this committee should rescue him from his contract by doing us out of our ability to get the product at a reasonable price. I think the consumer would be severely injured by that. The consumer would wind up paying a higher price in the end.

There are several other provisions in this bill that have to be mentioned. There is a right of first refusal that is discussed if a dealer-operated station is sold. That is pure mischief.

There is one in the Petroleum Marketing Practices Act that has been used by real estate speculators and competitors to bid stations away. What they do is go to a dealer and say, you have this right—and the dealer had no intention of exercising it—to buy this station. I will give you some money if you exercise your option. I will allow you to close on it, so that I can get the station at a bargain price.

It has created business transactions where there are three and four parties and suits and cross-suits. I submit there are very, very serious constitutional questions with the entire concept. That portion of the bill needs a good deal of attention before anyone should consider reporting it.

Finally, the dealers have attempted to go State by State to control competitors. They have gone from State to State legislature looking for pricing provisions, divorcement provisions, and price and allocation controls, all of which will make it impossible for reasonably small businesses such as ours that operate multi-State, many of them in 3, 4, 5, 15, or 20 States, to operate the way they do. It is going to be impossible to comply with 15 or 20 different State laws on who can own what and what price you can charge.

We think this legislation as it is drafted is mischief. We have heard people talking about deals and arrangements that can be made. Mr. Houston is willing to talk to the jobbers. We have tried to talk to him about the bill. We do not understand where we fit into this picture.

We are direct competitors. We are not branded. We are not part of this. There is no way they can write this bill, as far as we can see, that will not ruin our ability to compete and give the consumer low-price gasoline.

Thank you.

The CHAIRMAN. I have a few questions.

I understand that some jobbers are proposing an alternative to S. 326 to prohibit wholesale pricing that is higher than refiner or jobber retail pricing. Do you have any reaction to that proposal?

Mr. FULLER. I do not think we have a proposal in form yet.

As I mentioned, it seems to me that the big problem the dealer has is predatory pricing.

The National Oil Jobbers Council is presently conducting a study on that. We hope to have something to present later on, but we do not at this time, as an alternative to this bill. However, certainly not under the concepts of this bill.

The CHAIRMAN. Could you get your alternative to the committee as soon as you can before the committee intends to act on this bill?

I want to present all views to the committee when we get ready to act.

Mr. FULLER. This may take some time. I am not sure we can even come up with anything. We are just looking into it. However, certainly not within the concepts of S. 326.

The CHAIRMAN. I would like to ask Mr. Houston about that.

Mr. Houston, did you hear the question?

Mr. HOUSTON. I am not sure I did.

The CHAIRMAN. I understand that some jobbers are proposing an alternative to S. 326 to prohibit wholesale pricing that is higher than refiner or jobber retail pricing. Do you have any reaction to that proposal?

Mr. HOUSTON. We have been watching for——

On Monday of this week, Senator, I received a communication that indicated that such a general outline would be made at this hearing today and that in the near future we could expect the full details of a proposal. We await that with open arms.

We will gladly concede that we do not have a monopoly on how to solve the problem. All we want is to solve the problem. We will gladly try to work it out with the jobbers if they have such a program.

To delay us another year is to sacrifice hundreds of thousands of dealers and their families out there in businesses that cannot be recovered.

We need relief now, and I would urge you to urge them to put that plan before the committee so it can deal with it. We certainly will negotiate with them on trying to work it out.

The **Chairman**. Any plan that the jobbers have I wish you would get to us.

Mr. **Fuller**. Senator, I am not sure we are going to be able to come up with anything that would satisfy them. We are looking at it.

I do not believe anything was mentioned about the fact that——

The **Chairman**. Just come up with what you feel you can live with.

Mr. **Fuller**. We will certainly look into it and see if there is anything we can do.

The **Chairman**. Mr. Blum, I would like to get your reaction to such a proposal.

Mr. **Blum**. We would be absolutely opposed to it, because we cannot see how it could possibly work. You can tell people what kind of wholesale price to charge, but there is no law that prevents them from losing money at retail.

Back in the DOE regulatory time, DOE would say that you have to charge a certain wholesale price across the board. We would go in and ask: If that is the case, how come that particular retail unit is selling for less than our wholesale from the same supplier? The answer was: They are losing money at retail.

If you do not prohibit them from losing money at retail at the same time you fix the wholesale price, it is useless.

We submit that any legislation in this area is mischief. It is an open invitation to price fixing.

From the point of view of the person not in the branded major loop, who is an independent, it absolutely forecloses their ability to bargain in the marketplace.

As far as we are concerned, these pricing provisions are nonnegotiable.

The **Chairman**. Mr. Houston, would you care to respond to Mr. Blum?

Did you hear his statement a few minutes ago that he presented?

Mr. **Houston**. Yes, sir.

Let me say that at one or two points we have been in the negotiating stage, we thought, through our legal counsel with Mr. Blum, in an attempt to resolve their problem with the bill.

As yet, they have not produced the language as a suggestion to adjust the bill language so that it would meet and correct their objections.

We await with open arms any suggestions they have that would help us correct the predatory practices—either predatory costing or predatory pricing that is in the market system. We are seeking, as I said, only relief or fairness and not to damage anyone else. We will work with them.

The **Chairman**. I guess what I would like for you all to do is this. Mr. Blum seems to be in a little different position from the rest of the jobbers. I would like for him, a representative for the jobbers, and you or your group to get together and see if you can reach an agreement.

If you can't, we want to know it. If you can reach an agreement, we want to know it.

In other words, before we act on this bill, we want to give full opportunity to all groups to see if they can get together.

If they cannot get together, there is no reason to put the matter off. If they can get together, that is another thing.

Mr. HOUSTON. Mr. Chairman, I would be glad to initiate the request for that.

The CHAIRMAN. When the committee is ready to act on this bill, I would like to be able to present to them not only the bill but any amendments or any alternative. I want to present all views to the committee.

This committee has 18 members. We want to be able to present a picture to the committee for action.

I would like to hear from you all as soon as we reasonably can.

Mr. FULLER. Senator, I am not speaking for the national oil jobbers at all. I think I am probably speaking for the South Carolina oil jobbers.

We have met with Mr. Houston and some of his representatives. Right now we see no way to work this out. We are trying.

If they keep demanding that the dealers be given a guaranteed share of the market, I do not think we will be able to work anything out. That is what they are asking for.

The CHAIRMAN. Mr. Houston, do you want to respond to that?

Mr. HOUSTON. Yes, sir; I certainly do.

We are not, Mr. Chairman, asking for a guarantee on anything other than the right and opportunity to a fair and reasonable price, as anyone else buys for, and an opportunity to prove that we are more efficient at retail. If we cannot prove that, we do not deserve to survive; and we will not survive.

The CHAIRMAN. Counsel has some questions to propound to you.

Ms. TIFFANY. In what way do you feel that this bill guarantees a share of the market to the service station dealers?

Mr. FULLER. You are eliminating 16 major oil companies.

It is not mentioned in the bill as written, but Mr. Houston said that they were preparing an amendment. They are going to include the jobbers in it—or they would like to.

Who does that leave except the dealers?

Ms. TIFFANY. Mr. Houston, would you respond to that, please?

Mr. HOUSTON. The amendment we have offered as a part of the record today does protect and preserve the jobbers' functional allowance. It was not by our choice that the language was left out, but by their own choice. We are willing to put it in.

There is no preservation or development of a market share protection for branded dealers.

It is a matter of whether jobbers are buying gasoline at a lower price and are, in fact, retailers and not really jobbers. With that lower price opportunity of buying, then they have an advantage.

If we take away that advantage, competition will work in the system. If the jobbers are more efficient with an employee in a retail outlet, then the jobbers will survive with retail chain operations and independent dealers will not survive in the market system. That is in the public interest.

Ms. TIFFANY. Mr. Houston, would you agree to any possible alternative that would not require divorcement?

Mr. HOUSTON. We have stated in our 20 questions and answers—question 17 if I recall—whether or not divorcement is necessary.

We said that divorcement is necessary as a long-range correction of a situation where the major companies—the 15 or 16 top ones—are already controlling this 80 percent-plus of all segments of the industry; and that in the public interest, in our opinion, the Congress now make it impossible for them by enacting divorcement legislation to ever reach in and tap it and control 80 percent to the consumer's gasoline tank.

Our primary objective is to correct the predatory practices in the marketplace. We believe that both are necessary at this time, and we fully support both.

We are willing to compromise on the basis that divorcement with an open supply provision—and we have discussed this—which is adjusted in language slightly different than what it is now, is a possibility with the handling of the rack pricing as a separate bill, as the jobbers are discussing and what we thought they were going to outline to you today.

We are certainly willing to look at this and would support anything that would correct the market.

The CHAIRMAN. Let me propound two questions to Mr. Turner and his group.

After that, we are going to ask that representatives of the different thoughts expressed here meet with the staff—Republican and Democratic members of the staff.

We just want to know if there is any element you can get together on before we get these 18 people here to act on the bill.

Let me propound these questions to you, Mr. Turner, or to your attorney. Anybody can answer it.

Mr. Houston has testified that jobbers should not get a price advantage on purchases of gasoline that the jobbers retail themselves.

Would you comment on that?

Mr. TURNER. Senator, this is a very complex question.

Mr. Blum says that his members buy gasoline by negotiated price. You have to start with that price and take it all the way up.

Jobbers are not looking for any advantage. They are looking for a return on investment—the same thing as Mr. Blum.

The CHAIRMAN. Are you not concerned that the major oil companies are going to squeeze jobbers out of the market next if divorcement is not enacted?

Mr. TURNER. Our concern is not with the top 18 necessarily. We had a member yesterday who has a market and will be glad to provide this information to the committee if you would like. The cheapest price at wholesale, which is being sold 2 cents cheaper than that on the street by a small refiner—small would not be included in the 18—this is the real problem as far as we are concerned and not the 18 largest.

Senator, may I make one statement?

Mr. Fuller represents the South Carolina Oil Jobbers Association. I represent the National Oil Jobbers Council.

South Carolina has been negotiating with Mr. Houston for the last period of time. National has been working for over 3 years to try to reach some sort of compromise.

We are studying it; we have groups working on something that would be able to be presented to this committee.

There is no way that we can have anything in the timeframe that I think you want it in.

I just wanted to make that clear, sir.

The CHAIRMAN. Then what timeframe do you think?

Mr. TURNER. It will be next year, because we have been working 3 years on it now and we are no closer than when we started, as far as I am concerned.

It will take probably until the first of the year before we can come up with anything.

The CHAIRMAN. If you think there is any chance of your getting together, we would like for you to meet with the staff. You can arrange with them a time and place.

If there is no chance of getting together, you might as well forget it and let the committee vote on this situation when the bill comes up.

I want to thank all of you for your appearance here.

Anyone who wishes to submit any further questions—Senator Metzenbaum I believe does—for the record, please feel free to do that.

Senator Specter, you did not have any questions on this hearing, did you?

Senator SPECTER. I do not, Mr. Chairman.

The CHAIRMAN. We have a hearing that is supposed to start right now on some confirmations.

I want to thank all of you for your appearance here today.

The hearing stands adjourned.

[Whereupon, at 2:05 p.m., the committee recessed, to reconvene subject to call of the Chair.]

[The following was received for the record:]

PREPARED STATEMENT OF HENRY C. TURNER, JR.

Good morning, Mr. Chairman and members of the Committee. My name is Henry C. Turner, Jr. and I am President of Turner Oil Company, an independent petroleum products marketing firm in Salisbury, North Carolina. I am here this morning representing the National Oil Jobbers Council, a federation of 47 state and regional trade associations which represent approximately 22,000 independent, small business petroleum marketers. We estimate that these companies market more than 50 percent of the gasoline and 85 percent of the residential home heating oil sold in America today.

I am pleased to provide this committee with NOJC's position on S.326, a bill which would divorce certain refiners and establish a wholesale transfer price mechanism.

Statement of the Problem

One of the great problems facing small gasoline marketers is the ability of refiners to use upstream production and refining profit centers to subsidize their direct retail marketing operations. During periods of adequate or surplus gasoline supply, the incidences of refiner subsidization become much more apparent to independent marketers. This phenomenon was most visible during 1978 when gasoline sales volumes were at an all-time high. Subsidization can take other forms. In addition to predatory pricing and supply practices by integrated refiners engaged in the dual distribution of product through their own company outlets and through independents in the same area, there are other refiner practices which adversely affect independent marketers. These more subtle forms of subsidization, which the Department of Energy Title III report on subsidization chose to ignore, include the elimination of jobber prompt payment discounts, the elimination of jobber hauling allowances and the elimination of credit cards. Other ways subsidization occurs involve the entire credit policy programs of some refiners. Adherence to strict credit limits mandates that an independent marketer lower his volumes as the price of gasoline product rises. Fewer gallons at the same total price over time will eliminate even the most efficient marketers.

Those companies with access to profit centers other than retail marketing, those having production, transportation and refining profit centers upstream, are in the advantageous position to dump gasoline product through their own directly operated retail outlets at prices which do not necessarily reflect a full recovery of costs associated with the distribution, transportation and marketing levels of their integrated operations.

Today another problem is plaguing our members. Most of our members buy under contract from their suppliers. Now that there is a surplus of product many refiners are offering rebates of varying cents-per-gallon for purchases only on the volumes purchased above a base level. At the same time these same refiners are offering product to uncontracted purchasers on the so-called "spot market" at prices as much as 10-12¢ cheaper, according to published reports, with no mandated minimum purchase. In other words, marketers can purchase motor gasoline at a lower price from refiners with whom they have no contract than they can from a refiner with whom they have a contract. In several instances jobbers have been notified of a refiner's intent to terminate their contract because they have not purchased minimum monthly volumes.

We find these pressure tactics to be unfair. A simple price reduction, rather than complicated rebate schemes for contract jobbers, would enable independent marketers to sell more competitively and allow the motoring public a more reasonable price at the pump. The continuation of these complicated rebate schemes in the face of shrinking demand, raises questions as to the rationale for these ill-advised programs.

Perhaps, these schemes are merely being used to terminate those jobbers a refiner no longer wishes to serve, while remaining within the verbage of the Petroleum Marketing Practices Act (PMPA). We consider such tactics predatory, anticompetitive and inflationary.

The petroleum industry has just entered into the post-decontrol environment. The full impact of the Administration's decision has not yet been experienced. It may be some period of time before jobbers are in a position to evaluate the full impact of decontrol and its repercussions on refiner subsidization. To legislate a solution to market problems during this transition period is premature - the marketplace must be given the opportunity to recover from the years of regulation and resolve the problems it can. If old problems persist, or new problems develop, then we should look at legislating solutions. Unfortunately, the legislation before this committee does not adequately address the problems.

Wholesale Transfer Pricing

The most troubling section of this legislation for our members is section 3(c), popularly known as the "wholesale transfer pricing" section. If enacted, this section could potentially lead to the demise of approximately 25,000 independent lessee dealers served by jobbers and certainly have a negative impact on another 38,000 "open dealer" retail outlets served by jobbers.

As written, the legislation requires each supplier to post a single daily wholesale transfer price for each type of motor fuel. This wholesale transfer price shall be the price to each purchaser of motor fuel that day. There are three exceptions to this rule:

1) The supplier can meet but not exceed the equally low price of a competitor.

2) The supplier can add to the wholesale transfer price the cost of manufacture, sale and delivery of the motor fuel resulting from differing methods or quantities in which such motor fuel is sold or delivered.

3) Refiners, but apparently not jobbers, can assess a uniform and reasonable surcharge on sales of motor fuel as consideration for the use by the purchaser of the brand or trade name.

The impact of this provision is to virtually eliminate the wholesale function entirely. It forces refiners to absorb the economic return on performing the wholesale function in their wholesale transfer price. Where refiners do not perform the wholesale function, as in sales to jobbers, they still receive the economic return thus forcing the jobber to either perform the function at cost or placing his dealer's customers at an uncompetitive position in the market.

An example may better illustrate this point. (I have attached charts outlining this example to my testimony labelled as Appendices A and B). Assume a refiner establishes his wholesale transfer price for a given day for a given grade of fuel at $1.00 per gallon. This price includes several things. It includes the cost of the crude oil and the refining process as well as an economic return or profit margin. The bill before the subcommittee today indirectly dictates that his price also include the profit margin or economic return on performing the wholesale delivery function. This is true because the bill allows the refiner to add on to the wholesale transfer price only the cost of performing the wholesale function.

Assuming these add-on costs (franchise fee plus transportation) are 3¢ per gallon, the price that an independent dealer would pay for product delivered into his station would be $1.03.

The independent jobber will generally go straight to the refiner terminal or rack and purchase the product. By way of our example the jobber would also pay $1.00 per gallon. Assuming he is able to perform the wholesale function as cheaply as the refiner, his costs of delivering to an independent dealer also total $1.03. But the jobber has not yet made a profit. If he tries to add, say, a two-cent profit margin, which is less than a quarter of what DOE allowed under the old regulations, his price to the independent dealer is $1.05, thus placing the dealer in an impossible competitive position vis a vis the dealer served by the refiner. The end result is obvious. The dealer served by the jobber can not survive such a price disparity very long. He is in effect subsidizing a competing dealer served by the refiner.

But this is not the only problem contained in the wholesale transfer pricing section of the bill. Refiners which are not divorced under section 3(a)(1), are prohibited from transfering motor fuel to their direct operated stations at a price which fails to recover the wholesale transfer price. Therefore, a refiner in the example cited above could technically comply with this provision by selling gasoline on the street for $1.00 per gallon, 3¢ less than the price charged to the refiner dealer and 5¢ less than the price charged the jobber dealer. There is no provision in this legislation which requires the refiner to recover his costs in transporting the product into the station or even his retail marketing costs.

Section 3(c)(2) does prohibit a supplier from withholding sales at wholesale and then selling that product at retail at a price which fails to recover the same profits as if the motor fuel had been sold at wholesale. This section however is virtually unenforceable. What is withholding of product at wholesale? A supplier may "withhold" product at wholesale fully expecting to recover a greater profit at retail. Because of the competitive nature of the retail market, that expectation may not come true. A supplier could conceivably violate the law by making an error in business judgement with absolutely no intent to act in a predatory fashion. This type of netback determination has all of the flaws as did DOE's attempt to use netbacks in the infamous Title III study.

The attached charts illustrate many of the points I have tried to make. I need not advise this committee of the complex nature of the gasoline marketing industry. Trying to legislate relationships in such a complex area may be not only impossible, but also unenforceable and work to the detriment of consumers.

Divorcement

Since we are only a few months into decontrol it is our opinion that the Congress and the various state legislatures, which are considering divestiture and divorcement legislation, should not act hastily in attempting to restructure an entire industry -- an industry which is generally efficient and supplies the most economical motor fuel in the world.

First, we believe that divorcing the 16 or 18 largest refiners from retail marketing does little if anything to eliminate the possibilities for refiner subsidization. NOJC has witnessed subsidization by those refiners classified as small and independent to an equal if not greater degree than the large refiners. The small and independent refiners, which in many areas of the country set competition by the prices posted at their own directly-operated retail outlets, are not subject to the divorcement sections of this legislation.

Second, the problem of predatory pricing and supply practices and the more subtle credit policy problems do not always occur at the retail gasoline pump. Independent marketers also must compete with refiner-suppliers for the business of consumer purchasers of motor fuel. The consumer business is made up of thousands of bulk end-users such as rental car fleets, municipal fleets, trucking fleets, farms, ranches and small businesses. At the present time there is a growing subsidization problem in this category of the motor fuel business; in fact, jobbers have lost many sales contracts to refiners in this category of purchaser which today makes up some 32 percent of jobbers' annual volumes. Divorcement of refiners from operation of retail outlets only makes this category of purchasers more attractive to refiners wishing to dump motor fuels. This important category, already threatened, could easily go to divorced refiners. This element of the problem is not even addressed in this legislation.

Third, at present there are several state legislatures considering divestiture and divorcement legislation. Since the manufacture and distribution and marketing of motor gasoline is legitimately interstate commerce, it would seem appropriate that the Congress also consider it as such in this legislation. A patchwork of 20, 30, or 40 different state laws and even more local ordinances affecting gasoline marketing is not in the best interests of either the consumer or the marketers. The legislation before us does not preempt such state and local law and we consider this to be a significant problem area.

Dealer Supply Restrictions

There is one other area of the bill which I wish to address. Section 3(d) provides that no one shall restrict any dealer from purchasing or storing motor fuel from a source other than his regular supplier provided that the dealer provides point of sale notice to the customer that the gasoline is not the advertised brand. This provision does not apply if the dealer is subject to a contract which requires the dealer to purchase exclusively from a given refiner or distributor. Under such a contract a dealer could purchase from another only if his contract supplier can not provide him necessary volumes on terms and conditions available to him from another person.

This section gives a dealer virtually free rein to shop for gasoline from any supplier despite the fact that such dealer may be operating a franchise leased to him by the refiner or distributor. The refiner and distributor then must play the role of landlord and dramatically escalate rents to the point that the given property provides an adequate return on investment.

This provision is also anticonsumer. A consumer presumably enters a branded station to purchase branded product. He should not be forced to read on the pump that he is not purchasing branded product. Moreover, if the dealer purchases a load of contaminated gasoline from a seller, he could do untold damage to the image of the branded company in that market.

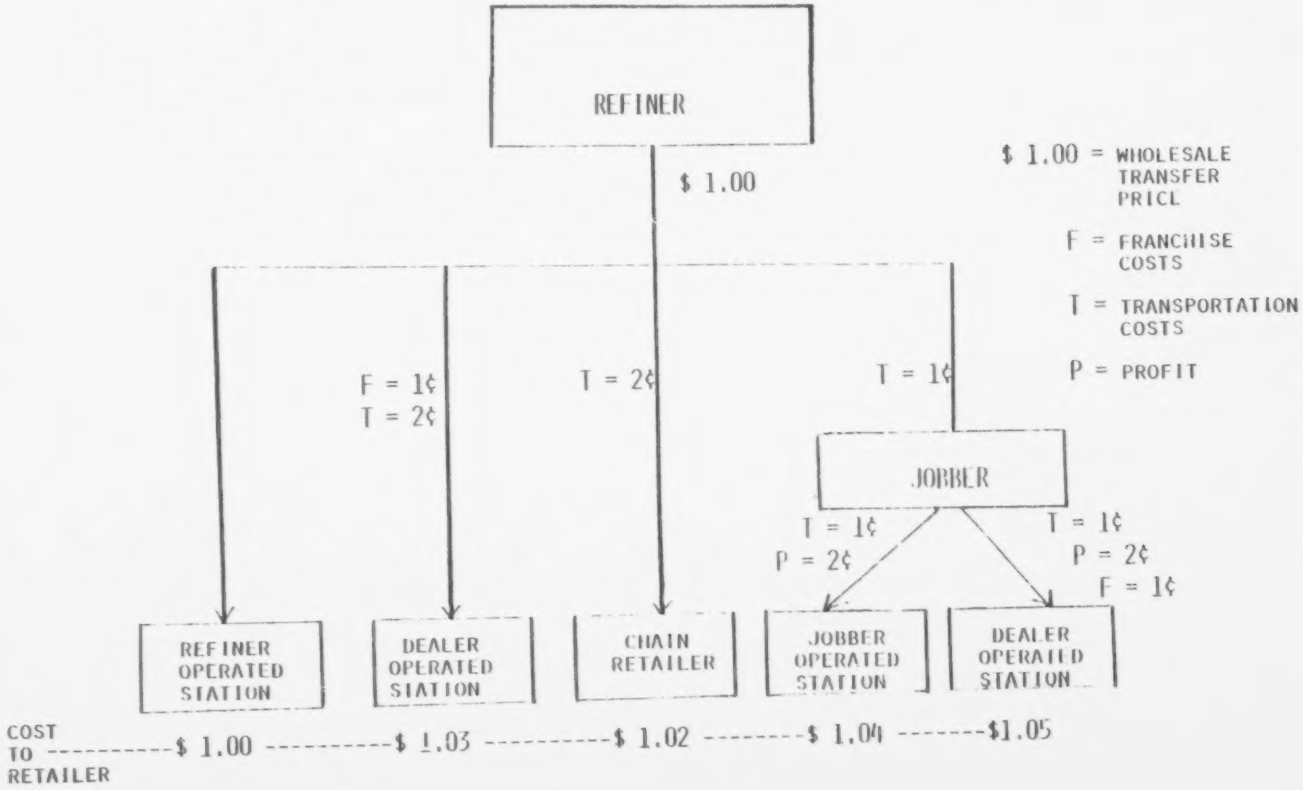
Conclusion

In summary, Mr. Chairman, the NOJC is acutely aware of the problem this committee seeks to remedy. Predatory pricing and supply practices have no place in the gasoline market, be they used by refiners, jobbers or any other marketers. We agree that subsidization has been a serious problem, one which could adversely affect what has been a truly competitive marketplace and one which NOJC will continue to study and to seek possible legislative solutions.

The problem we have at this time is in attempting to assess the impact of the recent decontrol actions on the marketplace, as well as decontrol's effect on previous subsidization actions. We would hope the free marketplace would be able to handle the major problems in our industry today. To legislate a drastic and perhaps needlessly complex solution at this time may only complicate the problems caused by the last eight years of regulation of our industry. This legislation, as we see it, would require complexities in the area of pricing that may well eliminate some marketers and thousands of dealers and force others into direct-operation of outlets in order to survive. The legislation before us is not a panacea; it does not divorce all refiners; it does not include all retail transactions within the language of divorcement; it does not eliminate conflicting state and local laws and it may very well have to result in some sort of federal controls to implement a very difficult and unfair pricing scheme. For these reasons, we are unable to support this legislation.

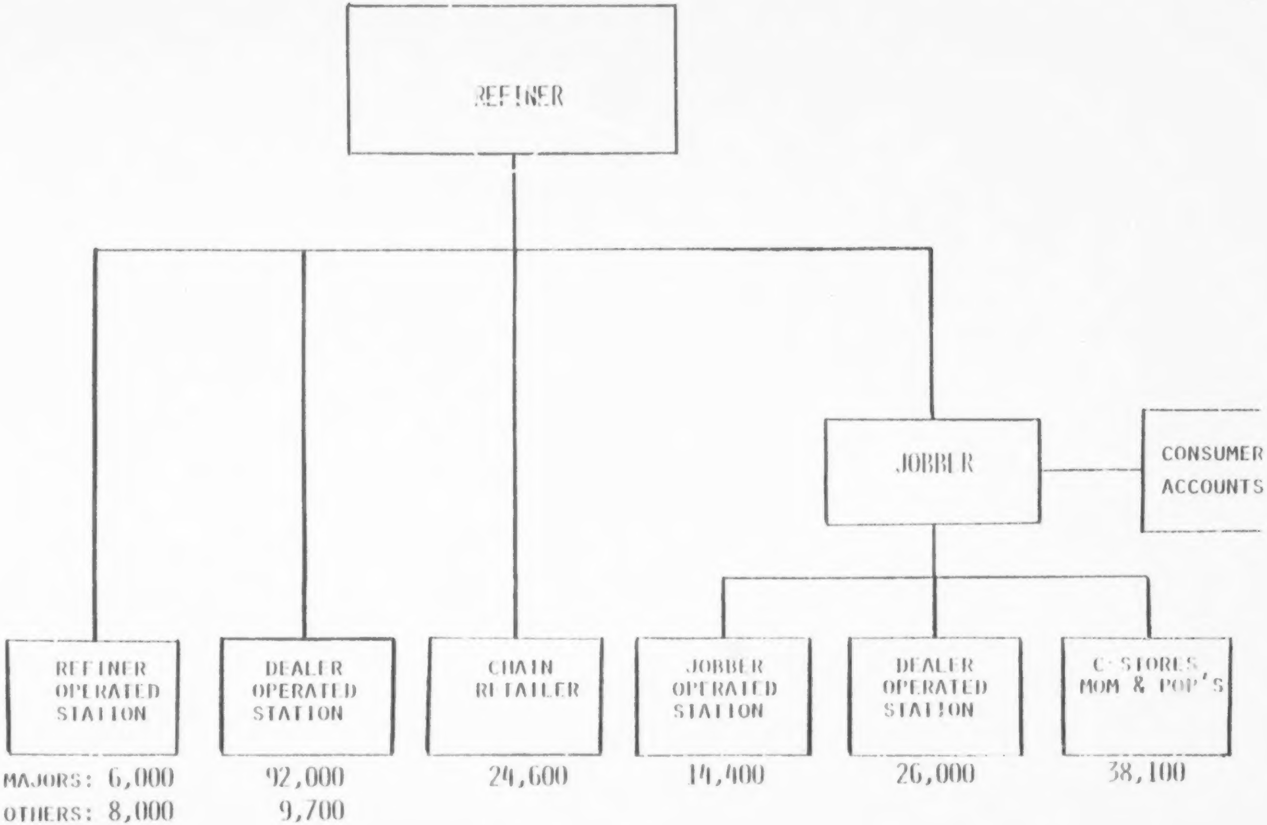
APPENDIX A

WHOLESALE TRANSFER PRICING MODEL


REFINER
$ 1.00
$ 1.00 = WHOLESALE TRANSFER PRICE
F = FRANCHISE COSTS
T = TRANSPORTATION COSTS
P = PROFIT
F = 1¢
T = 2¢
T = 2¢
T = 1¢
JOBBER
T = 1¢
P = 2¢
T = 1¢
P = 2¢
F = 1¢
REFINER OPERATED STATION
DEALER OPERATED STATION
CHAIN RETAILER
JOBBER OPERATED STATION
DEALER OPERATED STATION
COST TO RETAILER
$ 1.00
$ 1.03
$ 1.02
$ 1.04
$1.05

APPENDIX B

NUMBER OF STATIONS BY CATEGORY


REFINER
JOBBER
CONSUMER ACCOUNTS
REFINER OPERATED STATION
MAJORS: 6,000
OTHERS: 8,000
DEALER OPERATED STATION
92,000
9,700
CHAIN RETAILER
24,600
JOBBER OPERATED STATION
14,400
DEALER OPERATED STATION
26,000
C-STORES, MOM & POP'S
38,100

NOTE: ESTIMATES BASED ON 1979 DATA.
SOURCES: DOE, NPN, API, NOJC

PREPARED STATEMENT OF TOM FULLER

My name is Tom Fuller. I am President of Service Oil Company in Spartanburg, South Carolina. We are Phillips jobbers, handling both gasoline and heating oil. We serve 38 retail service stations - all of which are operated by dealers. Thirty-four of them lease from third parties or own their own stations - four operate as lessee-dealers which are owned by Service Oil Company.

I am appearing today as President of the South Carolina Oil Jobbers Association, a trade association representing approximately 280 member-firms engaged in the wholesale and retail distribution of gasoline and home heating oil. They are small-business firms in every sense of the word, averaging only 11 employees. Collectively, they handle just over one-half of the gasoline sold in South Carolina. In many areas of the State - the secondary and rural markets - they represent the only channel of distribution serving the retail service stations, commercial and farm accounts with petroleum products.

Over the years, our Board of Directors, which is the policy-making group in our Association, has considered the various proposals which would require that certain segments of the industry be prohibited from operating retail service stations. In each instance, we have engaged in full and serious discussion of the proposal at hand - and without exception, we have come to the conclusion that we could in no way support such a radical re-structuring of the oil marketing industry.

Our reasons are many and varied. We believe it is basically and philosophically wrong to attempt to legislate one particular segment of the industry out of business - to remove from the competitive picture an element which provides a substantial part of that competition. The structure of an industry ought to be determined by the wishes of the consuming public - not by a desire of one segment of that industry to remove one of the competitive forces. It is competition - when allowed to function - that brings to the public its petroleum products at the lowest possible cost. Requiring the major oil companies - or any other segment of the industry - to divest itself of its retail outlets is anti-competitive.

By the nature of our economic system, anything that is anti-competitive is also anti-consumer. We can see no possible benefit to the consumer of the removal of one or more of the competitive forces in the market-place.

We have heard complaints from dealers - yes, and from some jobbers as well - of unfair competition by the direct retail outlets of the major oil companies, and of some of the smaller refiner-marketers as well. We believe that some of these compliants are based on actual abuses - particularly in the area of predatory pricing. We believe that there are many instances of subsidization of these retail outlets from profits earned elsewhere in the system - despite the conclusions reached by DOE in its Title III study last year. But we submit that these abuses should be dealt with individually - through court action as may be warranted in each instance. The proposal to require these companies to divest themselves of their retail operations is far too drastic a solution, and would involve a further intrusion by the government into an industry which suffered through ten years of "too much government" only recently concluded.

There is another dimension of our opposition to the divorcement provisions of the bill under consideration. We do not believe the retail dealers intend to stop with legislation which deals with the major oil companies. The statement of their spokesman in Congressional hearings last year made this quite clear. He said (and I quote): "Also, the present special (discounted) price to jobbers, if continued with divorcement of jobbers from the operation of retail outlets may provide more absolute relief from unfair practices and improve competition than the change to rack pricing." (End of Quotation) He asked that the content of a study entitled "The Case for Legislative Relief From the Impending Destruction of Small Business and Competition in the Gasoline Industry" be accepted as part of his testimony. On page 67 of that report, we find this statement: "If for some reason the jobbers argue and convince Congress that they deserve a special buying price, then we have no choice but to ensure that the jobber uses that special buying price for its intended purposes. Thus, we have the following recommendation which would only be implemented if our rack pricing provision is not adopted along with divestiture.

"CONTINGENT RECOMMENDATION II

JOBBERS AND OTHER DISTRIBUTORS OF REFINERS WHO ARE REQUIRED TO DIVEST MARKETING, WOULD THEMSELVES, BE DIVORCED FROM THE DIRECT MARKETING OF GASOLINE" (end of quotation)

Now we see what the dealers really want. They will not be satisfied with legislation requiring that the giants of the industry get out of the retail market. That will merely be the first step. The next step - and the one they're really after - would remove small business other than themselves from the retail market. Only the dealers would be left - all other competition would have been legislated out of business.

Strangely enough, we find our feelings against divorcement expressed quite well in a speech a couple of years ago by one of the authors of that study just mentioned. Dr. Fred Allvine was speaking before the Georgia Independent Gasoline Marketers on September 19, 1978 on the subject of "Marketing Divorcement and the Private Brand Jobber". He was talking about the Maryland-style divorcement which had been enacted in that State. Quoting from Dr. Allvine's speech, "What is marketing divorcement legislation of the Maryland variety really all about? To a very large extent, it is class legislation designed to protect the branded dealers from changes occurring in the marketplace. We all know that there are far too many major brand stations to efficiently serve the needs of the public. Dealer organizations are attempting to slow the badly-needed attrition of major brand service stations. Furthermore, marketing divorcement will reduce the growth of gasoline-convenience store operations which is winning increasing public acceptance. Marketing divorcement legislation is clearly not in the public interest." That is the end of the quotation from Dr. Allvine.

I need not remind you that the same Dr. Allvine appeared before a Sub-Committee of this very Committee just last Fall and testified in favor of marketing divorcement - a drastic re-structuring of the industry which he stated not too long before was definitely not in the public interest.

We realize that there have been many casualties among the dealer population, particularly in the full-service area. In an industry which has been greatly over-built, one can reasonably expect that there will be casualties. There have been other contributing factors, too - the slowness of dealers to respond to changing customer buying preferences - their difficulty in obtaining financing to adapt their operations to these changes - and the artificial but none-the-less real impediments imposed by the Department of Energy under which they suffered far too long. Further, the increasing militance of dealers in seeking excessive legislative remedies to their problems has prompted many jobbers to consider additional direct outlets. In many cases, these are jobbers with many years of mutually beneficial relations with dealers.

Turning now to the pricing provisions of S 326, we point to the fact that, although the term "rack pricing" is not used, the effect is exactly the same. This is the same proposal which failed last year, and which should be consigned to the same fate in 1981.

The dealers would have you believe that there is no legitimate wholesale role in the marketing of gasoline. They say they should be able to buy at the same price as their wholesale supplier, even though they would be required to perform none of the functions of that supplier other than the mere supply of liquid products.

Jobbers are primarily in the wholesale business. They not only provide a substantial inventory of gasoline and distillate oils at bulk plants which are strategically located to best serve their retail outlets and their farm and commercial accounts. They move the product from terminals to their bulk plants in most cases, although the economics of the business dictate that some transport deliveries be made directly from the terminal to the retail outlet. Wherever possible, they provide enough storage capacity at the retail outlet so transport loads can be accommodated. Deliveries to commercial and agricultural accounts are made in lesser quantities, using the smaller tank-wagon trucks.

Credit card sales are handled through the jobber's office, performing that type of bookkeeping both for the dealer-operated outlets, and their own salaried outlets.

They maintain an inventory of tires, batteries and accessories at nearby locations, making these items quickly available to retail outlets - thus reducing the inventory which the dealer must carry at his own station. In this way, the investment which a dealer must provide in his business is reduced.

In many instances, jobbers have provided financing for a dealer to open his own business; and having this sort of interest in his business, he naturally expects to supply him with gasoline and diesel fuel. In this way, jobbers help to relieve one of the major pressures on dealers - that of securing adequate financing for a business which has suddenly become highly capital-intensive.

The wholesale function is a necessary one in this business - an entirely legitimate function which results in tangible benefits to the consumer. In large metropolitan markets, the major suppliers perform the wholesale function - and no one seems to question their legitimacy in that instance. In the secondary markets and in the rural areas which make up such a large part of South Carolina and the rest of the country, it is the jobber who performs this essential function. He came into being a generation ago because the major suppliers could not economically serve the less-populated areas. He exists today for the same reason.

The pricing provisions of this Bill would force the jobbers to choose between their wholesale business - and their retail business. That choice would inevitably be to continue in the retail business - and to expand it as rapidly as possible. The provisions of the Bill would allow him to recover only the cost of services beyond the mere supply of product - no profit on those functions. So we would see the small business firms which are now functioning as jobbers becoming chain retailers. We would see more pumper stations - and more convenience stores - neither of which has a place for a dealer. And who then will serve the commercial and industrial accounts - the farm accounts in the secondary markets? And where then will the dealers be? They will be victims of their own proposal.

We maintain that the wholesale function is a necessary one - and that if one group of small businessmen is destroyed by legislation, another will take its place. If the wholesale function is not a legitimate one, the system itself will destroy the wholesaler.

The dealers are asking why they should not be given the same price at the terminal as the jobber - as long as they buy in the same quantity. We say that the quanitity of purchase is only one of the criteria which should determine the price. If a dealers is willing and able to provide all the wholesale functions - the quantity purchasing, the transportation of the product, the bulk plant inventory, the warehousing of accessories, the providing of pumps and tanks and other equipment, the back-up bookkeeping, the financing - all the wholesale functions - then he should be allowed to buy at the rack and should receive the same functional discounts as any other jobber. There is nothing to prevent his entry into the business at the wholesale level. While we would not exactly welcome the additional competition, neither would we attempt to legislate him out of business.

The "open-supply" provisions of the Bill may sound reasonable to one who is not in our business. But when one reads it carefully, it could mean that one of my dealers would be free to buy from another source if my price happened to be slightly higher than the competing source. He could then buy from another source and run that product through a station which he may be leasing from me at so much a gallon - and I would receive no compensation whatever.

There is also the difficulty in determining liability for damages from contaminated product under an "open supply" arrangement. The Environmental Protection Agency's elaborate method of determining liability would have difficulty coping with product bought from a number of sources. Customers with damaged engines would encounter the same problem. We believe that de-branding a pump to allow unbranded product to be sold ought to be reserved for emergency situations in time of shortage of product.

I am a small businessman - one of nearly 15,000 over the country engaged in the wholesale distribution of petroleum products. I believe in the free-market system - bound only by such constraints as will prevent mis-conduct which will untimately destroy competition in the market place. The Bill before this Committee goes far beyond that - providing instead a complete re-structuring of the oil marketing industry. I believe the solution to be far worse than the problem.

Our industry is less than six months past the end of a period of unbelievable restraints imposed by the government to deal with a shortage that lasted only a few months. Many of my colleagues did not survive that seven-year period of controls. I ask you seriously to reject the idea that our industry cannot perform in the free-market - and abandon this proposal for retail divorcement. Congress has considered divorcement for more than 30 years - spending untold dollars of taxpayers money. My colleagues and I have spent far too much money opposing these proposals. I ask you now to turn to matters which are more constructive than the complete re-structuring of the oil industry. I ask you not to cater to the needs of one group of small businessmen at the expense of another group. I ask you to let me get back to running my business.

Thank you very much.

ADDENDUM

STATEMENT OF
TOM FULLER
President
SOUTH CAROLINA OIL JOBBERS ASSOCIATION
before
SENATE JUDICIARY COMMITTEE
on
S. 326
RETAIL SERVICE STATION DIVORCEMENT
July 30, 1981

This addition to our basic station of position opposing the passage of S. 326 is intended to emphasize two specific points relating to the operation of retail service stations.

The first is our prediction of what would happen if the major refiners, and subsequently the jobbers, were excluded from the direct operation of service stations.

Exhibit A is a simplified diagram of the petroleum distribution system from the refiner forward through the retail outlet. One can see that there are at least two types of retail service stations with respect to ownership and type of facility - offering several different types of combinations of services. The freedom of entry characteristic of our free enterprise system has enabled various elements of the petroleum industry to engage in retail marketing. The demands of the public have dictated that a variety of services be offered.

Assuming that the larger major oil companies were excluded from retail marketing, and that jobbers were subsequently prohibited from operating at both wholesale and retail levels (which we believe to be the goal of the service station dealers), the distribution system would undergo a violent re-shuffling, as the several elements made the choices dictated by the enactment of such legislation.

Exhibit B shows the likely result.

Refiners would obviously get out of the retail business, leaving a vacuum which would quickly be filled by chain retailers and others.

Jobbers would have to choose between their consumer bulk gallonage and their service station gallonage. Most would choose to discontinue serving the consumer accounts (leaving another vacuum to be filled) and concentrate on their motor fuel gallonage through retail outlets. Having made that choice, they would then look carefully at their operations, seeking the most efficient means of marketing available, and the best way to control costs. In all probability, that would mean more direct marketing (jobbers would have become chain retailers) - and more self-service.

So the effort to relieve the dealers of direct competition by refiners and jobbers would inevitably result in fewer opportunities for the dealers themselves. It is important to note that there is no place for the dealer in a chain retailer operation - no place for him in a convenience store chain - and few dealers have shown any interest in operating a self-service pumper.

It is our sincere belief that the honest efforts to give the dealers relief from certain problems will inevitably result in severe damage to the dealers themselves - if it results in the major re-structuring of the distribution system proposed in S.326.

We therefore respectfully urge its defeat.

Our second approach is more positive, and offers a more appropriate solution.

We agree that the dealers have many problems. Some of them are brought about by their own lack of response to the demands of the public. After all, customer preference cannot be ignored if one is to stay in business. The motoring public generally wants its gasoline at the lowest possible price, even if they have to pump it themselves. Generally, dealers have not responded to the demands of the public for self-service - except in split-island operations. And even there, much of the price differential is made up at the full-service island. A recent Lundberg Letter noted that the highest retail prices in the nation are found at full-service islands in split-island operations. Next highest were at full-service stations. These problems cannot be solved by legislation - but only by a willingness on the part of the dealer to respond to the demands of his own customers, and to adapt his business accordingly.

There is another area of the problem which may find its solution in legislation. I am referring to the situation where a dealer is competing directly with a retail outlet operated by his own supplier - either a refiner or a jobber. Where that supplier sells at a retail price lower than the wholesale price to his competing dealer - the dealer finds himself unable to compete. Such predatory pricing is the cause of dealer problems which may be addressed by legislation.

Let me say that these practices are not confined to refiner-operated stations - some jobber-direct stations must be included. We believe such pricing practices to be wrong at whatever level they occur.

We therefore have a possible solution to offer which would deal with this particular problem appropriately.

We believe the solution might lie in the area of fair-trade "below-cost" legislation, which would prevent such predatory pricing practices at all levels which engage in retail marketing. We would support such a proposal if the legislation met certain criteria:

1. It must be done outside any retail divorcement bill. We could not support it as a part of S. 326.

2. It must apply throughout the marketing industry, at all levels which engage in retail marketing.
3. It must involve only a direct comparison between the retail price at direct stations, and the dealer tankwagon price being charged a competing dealer.
4. It must allow leeway for a direct station (or any other) in meeting competitive prices.
5. It must provide procedures for redress and penalties for violation that are both workable and reasonable.

We have explored this alternative with the leadership of the National Oil Jobbers Council. They have accepted it for study, and have instructed their staff to proceed with the development of a proposal.

We have informed the Service Station Dealers of America of our action, and have invited them to join us in eliminating this unfair trade practice. We are confident that both groups, working together, can come up with an appropriate solution to this problem which affects both dealers and jobbers. This solution would deal with the basic problem much more appropriately than the complete re-structuring of our industry called for under S. 326.

Perhaps the Committee staff could be instructed to work with us and with the dealers jointly on such a proposal.

Thank you for hearing us.

Exhibits A & B

EXHIBIT A

PETROLEUM DISTRIBUTION

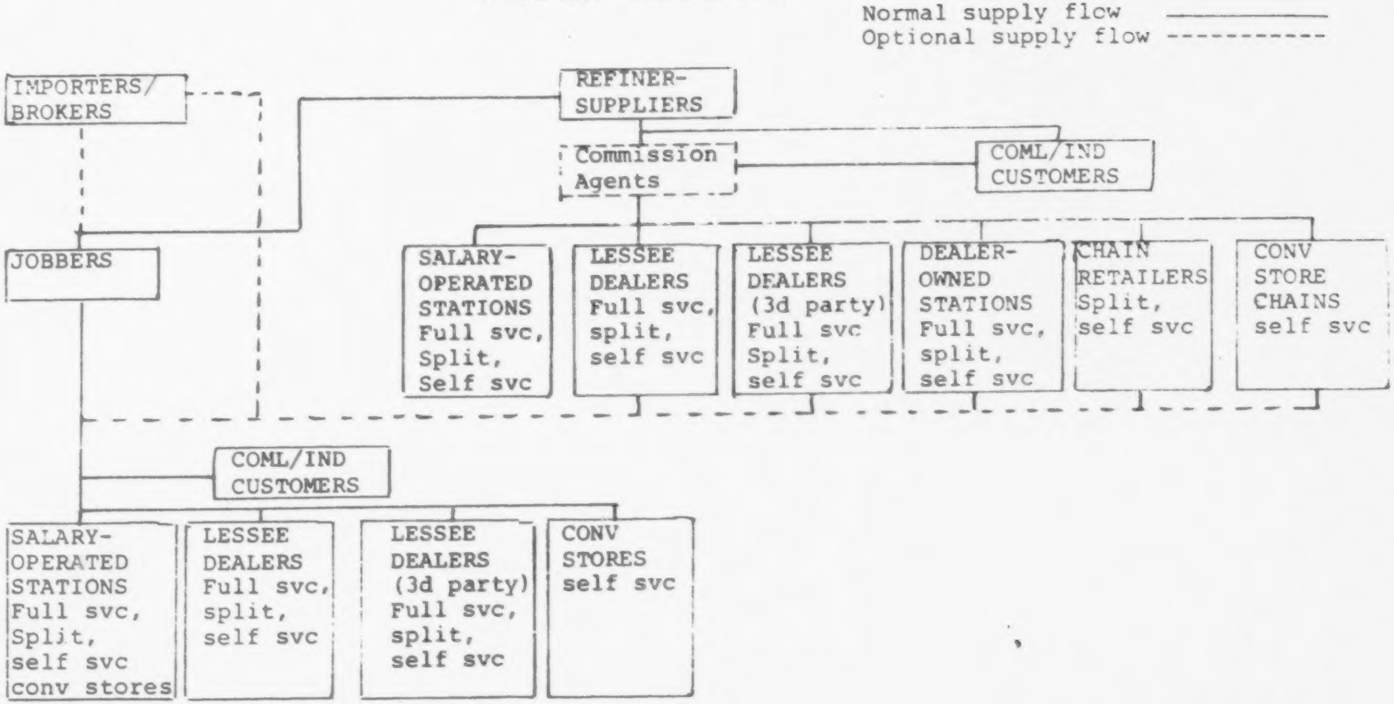
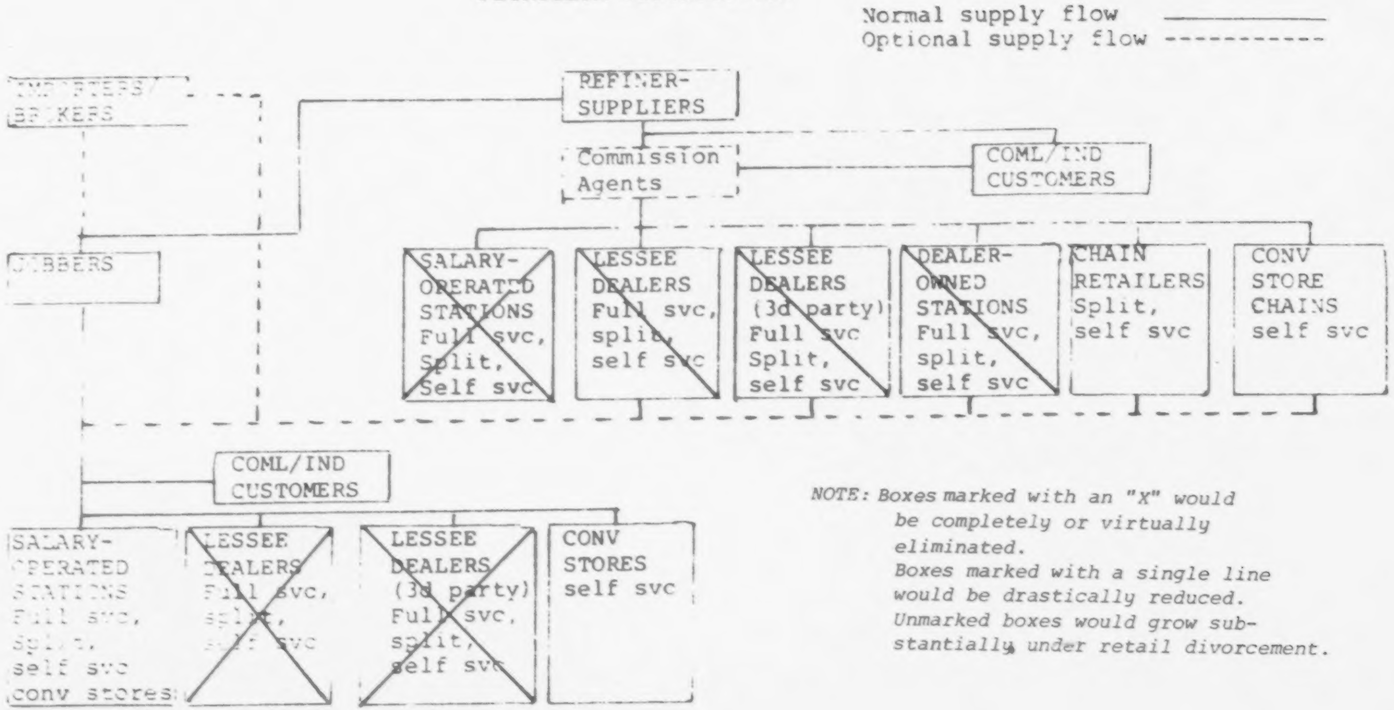

Normal supply flow
Optional supply flow
IMPORTERS/ BROKERS
REFINER-SUPPLIERS
Commission Agents
COML/IND CUSTOMERS
JOBBERS
SALARY-OPERATED STATIONS Full svc, Split, Self svc
LESSEE DEALERS Full svc, split, self svc
LESSEE DEALERS (3d party) Full svc Split, self svc
DEALER-OWNED STATIONS Full svc, split, self svc
CHAIN RETAILERS Split, self svc
CONV STORE CHAINS self svc
COML/IND CUSTOMERS
SALARY-OPERATED STATIONS Full svc, Split, self svc conv stores
LESSEE DEALERS Full svc, split, self svc
LESSEE DEALERS (3d party) Full svc, split, self svc
CONV STORES self svc

EXHIBIT B

PETROLEUM DISTRIBUTION


Normal supply flow
Optional supply flow
IMPORTERS/ BROKERS
REFINER- SUPPLIERS
Commission Agents
COML/IND CUSTOMERS
JOBBERS
SALARY- OPERATED STATIONS Full svc, Split, Self svc
LESSEE DEALERS Full svc, split, self svc
LESSEE DEALERS (3d party) Full svc Split, self svc
DEALER- OWNED STATIONS Full svc, split, self svc
CHAIN RETAILERS Split, self svc
CONV STORE CHAINS self svc
COML/IND CUSTOMERS
SALARY- OPERATED STATIONS Full svc, Split, self svc conv stores
LESSEE DEALERS Full svc, split, self svc
LESSEE DEALERS (3d party) Full svc, split, self svc
CONV STORES self svc

NOTE: Boxes marked with an "X" would be completely or virtually eliminated.
Boxes marked with a single line would be drastically reduced.
Unmarked boxes would grow substantially under retail divorcement.

PREPARED STATEMENT OF R. TIMOTHY COLUMBUS

My name is R. Timothy Columbus. I am a member of the law firm of Collier, Shannon, Rill & Scott and am appearing today on behalf of the Society of Independent Gasoline Marketers of America [SIGMA]. SIGMA is a trade association comprised of approximately 260 independent marketers and private brand chain retailers of motor fuels. SIGMA's members market motor fuels in 49 of the 50 states, and their motor gasoline sales represent between 10 and 15 percent of domestic retail sales.

In the petroleum industry, SIGMA's members are comparatively small businesses. As such, they recognize and appreciate this Committee's concern for the competitive viability of independent small businesses in the petroleum industry. SIGMA is compelled to oppose the enactment of S.326 because it will not accomplish this objective. This legislation will protect the special interests of only a limited number of competitors in the motor fuels market and, therefore, is anti-competitive and anti-consumer. SIGMA's position on S.326 may be summarized as follows:

(1) SIGMA opposes the divorcement provisions of S.326 as an unjustified form of government intervention in the petroleum marketplace. Moreover, recent experience indicates, that independent marketers are likely targets of future divorcement legislation.

(2) SIGMA opposes the rack pricing provisions of S.326 because they would distort the operation of historic and competitive pricing mechanisms to the disadvantage of many independent marketers and retailers.

I. SIGMA Opposes the Divorcement Provisions of S.326.

SIGMA opposes the government's intervention in the marketplace during times of adequate supply. The provisions of this bill which would prohibit certain refiners from participating in the retail market for motor fuels (the divorcement provisions) represent a radical form of government intervention in the marketplace. Essentially, such action would constitute a legislative apportionment of market shares. This type of governmental interference in the operation of market mechanisms could only be justified by the most substantial and convincing evidence of predatory activity. In SIGMA's view, no such evidence exists. Thus, SIGMA adamantly opposes divorcement.

Supporters of divorcement allege that such action is necessary to preserve them as a class of competitors in the retail market for motor fuels. They contend that the opportunity of a supplier to compete with its customers is inherently so unfair as to justify the exclusion of certain competitors from the market.

At the heart of the attack against refiners' participation in the retail market is the assertion that these companies are "subsidizing" their retail operations with profits derived from other activities, such as crude oil production or refining. According to the proponents of divorcement, the objective of such predatory behavior on the part of refiners is to control the retail market for motor fuels. SIGMA must dispute these allegations.

To the best of SIGMA's knowledge no credible proof of refiners' subsidizing their retail operations has been developed. In fact, the most exhaustive study of this issue ever undertaken, i.e., the Department of Energy's (DOE) study under Title III of the Petroleum Marketing Practices Act, Office of Enforcement, U.S. Department of Energy, The State of Competition in Gasoline Marketing, Book I (1981) (the Study), specifically rejected this thesis, by stating with respect to refiners' actions in the retail market: "Such behavior is inconsistent with the predatory subsidization hypothesis advanced by these refiners' competitors." Study at 154. Having rejected the claim of subsidization, DOE concluded that, ". . . at the present time no additional actions are necessary in order to ensure a functioning competitive gasoline market . . . ." Study at 236. In reaching that conclusion, DOE accepted the United States Department of Justice's conclusion that current antitrust laws not only provide an adequate remedy to predatory practices but also are preferable ". . . in that they concentrate on achieving an efficient market rather than on protecting certain classes of competitors." Study at 237.

The Federal Trade Commission (FTC) also recognized the dangers of divorcement in testimony before the Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business of the House Committee on Small Business in hearings held June 11, 1980. At those hearings, Mr. Rowe stated on behalf of the FTC, ". . . divorcement goes too far with respect to the meat axe that it wields with respect to driving an entire type of operation out of business . . . ." In response to this overwhelming opposition to divorcement from the agencies of the federal government charged with protecting competition, the only evidence brought forward by supporters of the predatory practices thesis has been examples of refiners' retail pricing during the past years. In light of the incredibly distorting effects of the Mandatory Petroleum Price Regulations during that period, such evidence cannot be viewed as conclusive.

SIGMA's members purchase from and compete with refiners. Thus, their position vis-a-vis their refiner-suppliers is not different than the dealers which support divorcement. However, SIGMA's members are convinced that their marketing efficiencies are sufficient to permit them to survive in competition with refiner-suppliers who historically have been unable to operate at retail as efficiently as independent marketers.

It is essential that the Committee consider a number of facts relevant to the motor fuels market. The demand for gasoline is down dramatically. For example, American Petroleum Institute figures for the month of February 1981 showed a decline in demand of over six and one-half percent compared to the same figures for 1980, the demand figures for which demonstrated a significant decline in comparison to 1979. Inventory figures for gasoline are at very high levels with stocks equalling 257,804,000 barrels of gasoline during the week of

May 29, 1981. This situation (large inventories and low demand), has resulted in a reduction in the utilization of refining capacity to 69.9 percent, a very low rate. In short, gasoline supplies are at very high levels, demand is declining sharply, and private brand marketers who are in the business of retailing gasoline must compete fiercely to remain in business.

Thus, current market conditions indicate that not all retailers of gasoline will be able to survive. The current retail distribution network for gasoline was built to accommodate demand which simply no longer exists. The failure of some retailing entities will not be limited, however, to branded dealers. Chain retailers, jobbers, and some refiners also will be forced out of the market. SIGMA accepts this fact as reflective of economic reality. It rejects the contention that this phenomenon is the result of predatory practices.

SIGMA believes that the divorcement provisions of this bill reflect an attempt by one group of competitors to insulate themselves from the harsh realities of competition. Moreover, the actions of dealer groups in the States indicate that they are not concerned solely with the major refiners, but rather seek to use the vehicle of legislation to bar competition from any other class of retailer. For example, at the urging of dealers, the General Laws Committee of the Connecticut General Assembly, on March 25, 1981, reported to the floors of both chambers legislation which would bar any entity which distributes motor gasoline at more than one level from operating a retail outlet. Likewise, SIGMA views the divorcement provisions of S.326 as but the first step in a campaign to limit competition at the retail level of the motor fuels market.

SIGMA urges this Committee not to endorse legislation which limits participation in the retail market for motor fuels by any entity. Such legislation would represent a radical form of governmental intervention in the marketplace during a period in which the marketplace is getting its first opportunity in almost 10 years to operate free of governmental influence. Such legislation, moreover, would establish a dangerous anti-competitive and anti-consumer precedent for future action aimed at other participants in the retail market, such as jobbers and chain retailers who compete with dealers. Because of the threat that legislation, similar to S.326 and under consideration in the States, poses to consumers and the free flow of interstate commerce, SIGMA respectfully urges this Committee to preempt this area from State action and reserve the power to act on these matters to the federal government.

II. SIGMA Opposes the Rack Pricing Provisions of S.326.

Of equal concern to SIGMA are the so-called "rack pricing" provisions of S.326, i.e., Section 2(b) of the bill. Private brand marketers have built their businesses on the basis of their marketing efficiencies. Their ability to minimize operating costs while maximizing sales volumes enables them to compete effectively by reducing the amount of fixed costs which must be recovered in the selling price of each gallon of motor fuels they sell. This ability is critical to their survival in the highly competitive retail market that now exists, and the competitive advantage that accrues from such efficiencies will be forfeited in a regulated marketplace.

During the last eight years, the petroleum industry and the federal government were involved in one of the most complex and least successful exercises in price controls in history. If we learned anything from that experience, it was that attempts to regulate prices in the context of a highly complicated industry are doomed to failure. Over seven years after their original promulgation, the Mandatory Petroleum Price Regulations were still the subject of "fine tuning" by DOE. SIGMA urges this Committee not to undertake a new, legislative (and therefore extremely difficult to adjust) program of price regulation in the petroleum industry. A brief review of some of the problems raised by the "rack pricing" provisions of S.326 will illustrate this point.

If enacted as currently drafted, the "rack pricing" provisions of S.326 would inflict a substantial competitive hardship on a significant portion of the class of individuals it apparently is intended to benefit, i.e., dealers. These provisions immediately would place dealers that are supplied by jobbers at a significant cost disadvantage relative to dealers that are supplied directly by the same supplier that supplies the jobber.

For example, terminal operators supply several classes of trade, including directly-supplied dealers and jobbers, who in turn supply dealers. Under the provisions of this bill, if such a terminal operator's first sale on a particular day is made to a directly-supplied dealer on a delivered basis, then the supplier's daily wholesale transfer price [DWTP] will equal its delivered price minus the cost to it of making the delivery. However, a delivered price reflects more than a supplier's rack price plus the cost of delivery. It reflects profits on the performance of services, such as transportation, the extension of credit, and other functions associated with wholesale distribution. Thus, if the supplier makes a profit on the use of the trucks required to make that delivery, then its DWTP will reflect not only the profit that it would make on a rack sale, but also the profit on the use of its equipment. Under this set of facts, the supplier's price to a jobber will include this profit as well as the profit realized on its performance of other wholesale functions.

It is fair to assume that any jobber which delivers product to its dealer customers also will need to make a profit on its transportation equipment and its performance of other services. Thus, that jobber's dealer customer will be charged a price which reflects not one increment of profit for the performance of transportation and other services, but two such increments, i.e., the jobber's profit and that of its refiner-supplier. Such a jobber-supplied dealer therefore will be placed at an immediate competitive disadvantage. SIGMA does not believe that this result was intended by this Committee or by the dealers who support this bill.

As this Committee is aware, this bill's prohibitions against charging unlike prices to different customers are significantly broader than the prohibitions of the Robinson-Patman Act. Robinson-Patman's prohibitions apply only to prices charged to customers who compete with each other. S.326's prohibitions apply to all customers. While this difference may not appear particularly important, in the context of the petroleum industry, particularly during periods of intense competition, this distinction is crucial and may damage the very dealers it is intended to protect.

Suppliers historically have made price allowances to aid customers in a particular market which are experiencing intense retail competition. Such allowances, commonly called temporary competitive allowances [TCAs], enable a dealer to remain competitive during local "gas wars." It has been good business for suppliers to afford customers TCAs. Without this kind of assistance, the supplier risks the loss of a customer that otherwise would not be able to compete in its market area. Because TCAs are afforded only on a limited number of gallons, offering a TCA makes economic sense. The "rack pricing" provisions of S.326, however, would require a supplier to institute the allowance not to just one or two customers in a specific market, but rather to all of its customers, regardless of whether those other customers were experiencing the particular problem. In short, a supplier implementing a TCA for a particular customer would be required to reduce its selling price on all of the gallons which it sells. Under such circumstances, it is unlikely that a supplier would institute a TCA to help a particular customer or small group of customers that is experiencing a severe problem. Thus, the "rack pricing" provisions of S.326 may injure dealers that otherwise would have remained economically viable.

In conclusion, SIGMA recognizes and appreciates the concern and good intentions of this bill's sponsors. However, the answers put forward in this legislation are the wrong answers to the wrong questions. The retail market for motor fuels is going to be a difficult market in which to survive for the foreseeable future. This is so not because of anti-competitive practices, but because of economic realities that will require all participants in that market to adjust to conditions which they have not encountered before, such as declining demand. Those who tell you that the answer to intense competition is the limitation of competition are requesting special protection at an enormous cost to efficiency and the consumer. SIGMA respectfully urges you to reject that request.

SIGMA appreciates this opportunity to share its views and concerns with you. I will be happy to respond to any questions that my testimony may have raised.

PREPARED STATEMENT OF JACK A. BLUM

My name is Jack Blum. I am the General Counsel of the Independent Gasoline Marketers Council, a trade association of nonbranded independent marketers of motor gasoline. Council members operate groups of retail stations under their own brand name. Most members operate in more than one state and all of the member companies are independent, many of them family owned. We, too, are independent retailers and our views are quite different than those of the association which is pressing for this legislation.

The fact that our members operate under their own brand names has given them the ability to bargain with their suppliers. They have given up the advantage of national advertising, nationally sponsored credit cards and major brand identification so that they can have market flexability. This difference in business operation accounts for our differing views on the present legislative proposal.

Gasoline demand has been declining steadily for the last two years. In March of 1981, the nation used 15.1% less gasoline than we used in the crisis period of March 1979. In fact, present gasoline demand is at a level which three years ago would have been considered a national emergency requiring rationing. Refinery runs are at the 70% level and a number of refineries have been mothballed.

Inasmuch as consumers are using less gasoline, it stands to reason that these are difficult times for everyone in the business of refining, marketing and distributing the product. The volume declines mean that marginal businesses will go under and larger firms will be forced to restructure and redirect their resources in order to survive. No one I talk to expects these trends to change in the foreseeable future. In fact, the decline in consumer demand will continue.

Members of the Council have been systematically closing marginal retail units over the last two years in response to these fundamental market changes. They have also been cutting costs to the bone to remain competitive. A shakeout is inevitable and no legislation can or should attempt to salvage marginal, inefficient refiners, marketers or distributors.

We believe that many branded dealers are seeking protection from these economic fundamentals by talking about competitive problems, many of which ended when price and allocation controls were removed. The price and allocation regulations promulgated in 1973, had a "class of purchaser" rule which cast differentials among "classes of trade" in regulatory cement for most of the seven-year period of DOE regulation. As a result, jobbers as a class were given the May 15, 1973 jobber discount until this Fall by regulation. The jobbers took advantage of this regulatory protection to expand their businesses but the regulations also protected the supplies of branded dealers and in some cases required refiners to sell them gasoline at prices far below market clearing levels.

When price and allocation controls were lifted most refiners eliminated the jobber differential and have been selling gasoline at a "rack price" to all comers. A brief five month experience with competitive pricing is not enough to tell us whether the problems which the dealers have raised have been solved. We feel that much more experience with a free market is necessary before Congress tries to legislate another pricing system and before we will be able to separate competitive problems from problems relating to the decline in gasoline demand.

The legislative solution proposed in S. 326 would assist troubled branded dealers by curtailing their competitors and raising consumer prices. It would sacrifice the competitive edge of our sector of the independent marketing sector without substantially changing the underlying economic reality of declining sales and declining demand, the real cause of the branded dealer's problem.

The competitive issue the branded dealers pressing for this bill use as their major argument, is that they compete with their suppliers who sell them product at a price higher than they transfer it to their own stations. We face the same problem competing with refiner direct stations and it can be solved with simple vertical divestiture legislation.

Instead, the bill before this committee purports to control the transfer price of gasoline to supplier owned stations by making it unlawful to sell to a directly owned unit at prices lower than the daily wholesale price.

As written, the transfer pricing provisions will not work. There is no legal prohibition on downstream operations losing money. Thus, if a high wholesale price is posted, all that will occur is that profits will be taken at the wholesale or refinery level. In fact this is how some wholesalers and refiners avoided the "class of purchaser" rules imposed by DOE. It is why legislation which seeks to solve the problem of vertical integration short of requiring divestiture cannot work. Ironically, we believe the provisons of S. 326 imposing price rigidity will work and competition among the various suppliers will be substantially reduced.

S. 326 would impose drastic changes on the entire wholesale market. It would limit competition among refiners and limit the ability of other types of independent marketers and distributors to compete effectively by bargaining with their suppliers.

As you know, gasoline is a fungible commodity. The price of gasoline changes on a continuing basis as does the price of other commodities such as corn, wheat and soy-beans. At any given time, the price depends on the supply and demand situation in the marketplace.

Our members play refiner suppliers off against each other to buy product at the lowest possible price. They are able to do this because they own their own stations and use their own brand names. They adopted this style of business operation to get just this advantage. The branded dealers have chosen to tie themselves to a single supplier and have as the result of their free choice surrendered their ability to bargain. They should not be protected from the consequences of their business decision.

The proposed legislation will end the present fast moving marketplace and create a system of daily pricing. Deviations from the daily pricing by suppliers will have to be defended and justified and an inappropriate price reduction will subject the offending firm to penalties.

Historically, price discrimination against small retailers has been covered by the Robinson-Patman Act. The Robinson-Patman Act applies to the gasoline business as it does to all other businesses. The retail dealers who are pressing for this legislation claim the Robinson-Patman Act is inadequate because it does not cover direct competition by a supplier. But as I have indicated, the proposed bill won't solve that problem either because it cannot prevent a refiner or wholesaler from losing money at the retail level.

The leading case on the applicability of the Robinson-Patman Act to gasoline marketing is Standard Oil Co. v. F.T.C., 340 U.S. 231, 71 S.Ct. 240 (1951). In that case, the Federal Trade Commission alleged that giving a jobber a discount not available to a dealer was a violation of the act. The case turned on the "good faith meeting of the competition" defense. The court said that the refiner's discount to the jobber was to keep his business and was therefore justified.

The purpose of the defense is clear. It permits a supplier to keep his customer by meeting a competitor's lower prices. The court opinion in Standard Oil reviews the legislative history of the Act and in the review footnotes the testimony of the then Assistant Attorney General in charge of antitrust who said in testimony, "While we recognize the competitive problem which arises when one purchaser obtains advantages denied to other purchasers we do not believe that the solution to this problem lies in denying the sellers the opportunity to make sales in good faith competition with other sellers".

His position and the position taken by the court supports this underlying economic premise of the antitrust laws.

The Standard Oil opinion then seeks to reconcile the Robinson-Patman Act with underlying antitrust philosophy and concludes, at p.250:

> "There is nothing to show a congressional purpose in such a situation, to compel the seller to choose only between ruinously cutting its prices to all customers to meet the price offered to one or refusing to meet the

> competition and then ruinously raising its prices to its remaining customers to cover increased unit costs."

Finally the court says that even if the discount made to meet competition at one level causes competitive injury at other levels the defense is absolute.

The Standard Oil case was recently reinforced and broadened by the holding in Great Atlantic and Pacific Co. Inc. v. F.T.C., 440 U.S. 75, 99 S.Ct. 925 (1979). In that case A & P told its supplier Borden that it had another bid for private label milk and that Borden's bid was "so far out of line it is not even funny."

Borden rebid at a far lower price and the FTC went after A & P for misleading Borden and inducing an illegal discount. In dismissing the complaint the court said at p. 933:

> "Imposition of §2(f) liability on petitioner in this case would lead to ... price uniformity and rigidity.
>
> In a competitive market, uncertainty among sellers will cause them to compete for business by offering buyers lower prices. Because of the evils of collusive action the court has held that an exchange of price information among competitors violates the Sherman Act. U.S. v. Container Corp., 393 U.S. 333, 89 S.Ct. 510. Under the view advanced by the respondent, however, a buyer, to avoid liability must either refuse a sellers bid or at least inform him that his bid has beaten competition. Such a duty of affirmative disclosure would almost inevitably frustrate competitive bidding and by reducing uncertainty lead to price matching and anticompetitive cooperation among sellers."

As the meeting of the competition defense is framed in S. 326 it adds language not found in the existing meeting of the competition defense. The added words are "but not to exceed". Inasmuch as existing law prohibits using the defense to exceed the discount offered by a competitor we must conclude this is an attempt to require collusive behavior by suppliers and disclosure of competitive price information if the defense is to be invoked. The addition of these words would signal a major departure from existing antitrust policy.

I urge every member of this committee to read these cases to gain an appreciation of the competitive and legal problems which will be created by attempting to narrow the meeting of the competition defense. I am sure that no member of this committee would want to be responsible for legislation which encouraged gasoline price fixing and in my judgment that is what this bill would do.

We believe, further, that the legislation as written would lead to frivolous lawsuits based on branded dealers' misunderstanding of exchange transactions. Many of our members pick up product at refinery racks and pay less than the going rate at that refinery rack at that time for the product because they have in fact purchased the product through an exchange with another supplier at another location. We can easily foresee a situation in which lower-priced product received through an exchange is perceived by a dealer as a violation of the rack pricing provision and becomes the basis for suit. In these inflationary times, Congress should not encourage litigation against companies which cut prices.

Ironically the bill will also prevent jobber and terminal operator suppliers from helping their own dealers meet lower street prices charged by refiner competitors. That is because the good faith meeting of the competition defense in this bill is limited to "price reductions offered to independent wholesale purchasers in good faith, to meet but not to exceed, competing price reductions offered by others to those independent wholesale purchasers." It does not cover reductions by a jobber to enable an individual dealer to lower his price so that he can compete with a refiner-run retail unit across the street. Indeed the good faith meeting of the competition defense in existing law was held to apply only to wholesalers and to prevent discounts from wholesalers to retailers which would enable a retailer to meet a competitior's lower street price. See F.T.C. v. Sun Oil Co., 317 U.S. 505, 80 S.Ct 358 (1963).

To expand this holding to jobbers and terminal operators would create serious problems for jobber supplied dealers and for ultimate consumers who would not enjoy the benefits of price competition.

There is a deep seated suspicion throughout our organization that the real complaint of the branded dealer is not against his major competitive supplier but against his nonbranded competitor across the street who sells at a lower price. The branded dealer has made his business decision to operate as the distributor of a single major brand product. His decision deprived him of bargaining power. Other independent businessmen, including our members, have chosen a different business strategy and are making it work. Their mode of operation gives them greater market flexibility and bargaining power. This committee should not solve the business problems of the branded dealer by depriving other independent businessmen of their flexibility.

The Petroleum Marketing Practices Act and this legislation contain "right of first refusal" provisions which give the dealers the option to buy retail units which their suppliers decide to sell. This bill would add Small Business Administration financing to assist the dealer in exercising the legally granted purchase option as divorcement is accomplished.

As we understand the original intent of the legislation, it was to allow dealers who wish to remain in business to buy the stations they operate from their suppliers.

In practice the Petroleum Marketing Practices Act "right of first refusal" has become a source of mischief and should, we believe, be repealed. Further, the "first refusal" provisions of this bill should be studied carefully.

Several of our members have negotiated for the acquisition of groups of stations from major companies and from branded jobbers. In at least three cases, competing independent marketers and real estate speculators have gone to a single dealer and offered him a small sum of money to exercise his option. In each of these cases, the dealer had no intention whatsoever of remaining on the premises and, indeed, arranged "back to back" sales of the property to the third party. The third party's sole purpose was to break up the original deal. This use of the PMPA is contrary to the intention of Congress and should be stopped by an appropriate amendment.

We also believe that a provison must be added to this bill to require a dealer who exercises his option and gets SBA financing to remain in business on the premises for at least one year and to impose penalties on third parties who attempt to buy the dealer's option or use the dealer as a "straw man" to destroy another transaction.

This committee should be aware that the same dealer organizations which are seeking this legislation are concurrently seeking a variety of protective bills in various state legislatures. These bills run the gamut from the continuation of Federal allocation and price controls on the state level to a prohibition against chain operations of retail units. If each of the fifty states adopts a different bill the operations of companies in our organization will be very difficult. A number of them operate several stations in each of as many as forty states. They cannot deal with forty different state regulatory schemes. If this committee decides to report a bill, we ask that it include a provision preempting all state action in this area.

Finally, the bill designates the Federal Trade Commission as the agency responsible for enforcement. It will require the promulgation of a complex web of regulations and take badly needed manpower away from the other antitrust law enforcement tasks now assigned to the Commission.

DIVORCEMENT OF MOTOR FUEL SERVICE STATIONS

WEDNESDAY, OCTOBER 21, 1981

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2228, Dirksen Senate Office Building, Senator Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Grassley, Specter, and Metzenbaum.

Staff present: Marcy Tiffany, antitrust counsel and chief economist; and Peter Chumbris, chief antitrust counsel.

OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The CHAIRMAN. The committee will come to order.

This hearing is the second that this committee has held on S. 326, the Small Business Motor Fuel and Marketer Preservation Act of 1981.

This matter is of some urgency since many believe that if the legislation is not enacted in the near future, its usefulness will be greatly diminished.

Thus, this will be the last hearing before the committee proceeds to consider and vote on this bill.

At the first hearing, we received testimony primarily from service station dealers and jobbers. Today we will hear from Government witnesses and representatives of the refining industry.

Our first witness is the Honorable William F. Baxter, Assistant Attorney General for Antitrust of the U.S. Department of Justice. He is one of the most knowledgeable men in the country on antitrust matters.

We are very pleased to have you with us, Professor Baxter, and you may proceed.

At this point, we will insert the statements of Senators Denton and DeConcini into the hearing record.

[Prepared statements follow:]

OPENING STATEMENT OF SENATOR JEREMIAH DENTON

Good morning Mr. Chairman, I am pleased that the Judiciary Committee is holding hearings on S. 326 this morning. This legislation could affect the price that the consumer will pay at the gas pump, and would also address the fundamental issues of how, when, and to what extent the Federal Government should intervene in this particular market. The bill's noteworthy purpose is to halt the attrition of small independent franchised dealers.

There are those that contend that the effects of this legislation would be too far-reaching, that the oil industry would be fundamentally changed, that the consumer would have fewer options in purchasing gasoline, and that the Government would have additional regulatory functions. Singly or collectively, these results of S. 326 could be very serious and we must study them thoroughly. Hasty consideration of a bill of this magnitude would only serve to ignore the inequities that currently are developing. Moreover, I must be assured that S. 326 will not create further distortions in the oil industry. Hopefully, we will examine the question of whether or not S. 326 can accomplish its goals without debilitating an industry so recently deregulated and presently undergoing fundamental re-structuring.

I am pleased that we have this opportunity to educate ourselves on the merits of this bill. It is my hope that the best solutions for the problems within the oil refining and marketing industry will emerge from this hearing.

OPENING STATEMENT OF SENATOR DENNIS DECONCINI

Today we are dealing with a piece of legislation, S. 326, which will require the divorcement of motor fuel service stations from operation by certain producers and refiners of motor fuels and will control sales by producers and refiners of motor fuels. This bill has many differing economic interests, all of which warrant our utmost consideration.

On one hand, we are dealing with the plight of independent service station dealers. Between 1972 and 1979, approximately 80,000 dealers have gone out of business. Furthermore, this decline seems to be continuing at a rate of 10 percent per year. It has been asserted that this grave attrition rate is due to the predatory tactics of the large refiners. Others feel that these companies have gone out of business due to pure economic factors. It is one of the roles of this committee to determine if these small businesses are failing due to unfair pricing mechanisms and if anything may be done to remedy the situation.

On the other hand, we have the competing interest of the large refiners who, if S. 326 is enacted, must divest themselves of the direct operation of all retail service stations. These refiners feel that the divorcement provision of this bill will reduce competition by driving that class of competitors out of the retail market.

Ultimately, we are faced with the question of whether or not S. 326 will improve or erode the pricing and competitive position of the public in the retail fuel market. The American public is rightly concerned with the escalating cost of gasoline. It is our duty to be sensitive and responsive to the issue of this bill's impact upon consumer prices and to do anything within our power to halt the increase in gasoline prices.

And thus, it is due to the importance of this bill to many segments of our society that this entire committee will be carefully listening to the testimony presented before this committee today.

STATEMENT OF WILLIAM F. BAXTER, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. **BAXTER**. Thank you very much, Mr. Chairman.

I am grateful for the opportunity to appear before the committee this morning and express the position of the administration with respect to S. 326.

The administration strongly opposes the passage of this legislation. The legislation has three principal features, at least viewed from the standpoint of competitive markets.

First of all, it would require the divorcement by major refiners of operating control of all retail service stations.

Second, it creates a pricing phenomenon known as the wholesale transfer price. In addition to being an administrative monstrosity, this pricing device, particularly when coupled with the open supply provisions of the bill, essentially forces all transactions into a spot market mold and effectively deprives the industry of the efficiencies and cost savings which are frequently associated with more long-run types of contractual provisions.

Finally, if the bill is enacted, there are the undoubtedly necessary but nevertheless cumbersome and expensive reporting requirements and enforcement provisions that are lodged with the FTC.

Enactment of this bill would result in a severe disruption of the petroleum distribution system in the United States. There is no evidence that any such disruption is necessary. We regard the bill as a cure for which there is no known illness.

The CHAIRMAN. Would you suspend just a minute? I have a couple of urgent calls I have been waiting for and one of them has just come through.

Mr. BAXTER. Surely.

[Recess taken.]

The CHAIRMAN. Professor Baxter, you may proceed now.

Mr. BAXTER. Thank you, Mr. Chairman.

There really is not much doubt that in recent years we have seen a reduction in the number of independent dealers and an increase in the number of jobber- and refiner-operated stations.

It is argued that this undoubted phenomenon stems from some sort of a competitive defect or some sort of unfair behavior—subsidization or predation or some such concept—on the part of the refiners.

Those arguments entirely misconceive the nature of the relationship between refiners and their distributors. They are not competitors in any meaningful sense of the word, even when the refiners are engaged in dual distribution. They are more nearly partners in the marketing of the refiner's product.

The dealers, in a sense, are dependent on their refiners; but the refiners are also dependent on the dealers.

The refiners would like to have the dealers distribute their product at the lowest possible price to the consumer so that they can sell more, and they would like to hold the dealers' margins as narrowly as they possibly could hold them because that is what is profitable for the refiners.

Of course, the dealers on the other hand would like their margins to be as wide as they possibly can be.

Those matters are matters for private bargaining between the refiners and their dealers. Both parties have other alternatives and the relationship between them is more one of interdependence than dependence on either side.

Congress in 1978 enacted the Petroleum Marketing Practices Act. Pursuant to that legislation, the Department of Energy studied this phenomonen of reduced numbers of independent dealers and filed its report in January of this year.

That report found absolutely no evidence of predation or subsidization of owned stations on the part of the refiners.

That conclusion, of course, is not surprising. The refiners would have no incentive whatsoever to engage in that sort of conduct. It would not be profit-maximizing for the refiners, and it is hardly surprising that they are not adopting a course of action which would not be profit-maximizing from their standpoint.

The situation is somewhat analogous to the many, many situations in our economy where a manufacturer decides both to buy some fraction of a part or component and also to manufacture internally that same part or component—a so-called make or buy provision. It is often done simply to make sure that the outside supplier is affording a check on the cost-effectiveness of their own operation.

Those two modes of acquiring inputs can coexist quite harmoniously. So also can a combination of independent and owned distribution.

Moreover, if anything resembling predation which was likely to put competitors out of business were to exist, an antitrust remedy would be available. It would be available without the intrusive, expensive, day-to-day regulation that this legislation contemplates.

The report of the Department of Energy, on the contrary, found that there were a number of other reasons for the phenomenon we are observing.

In particular, it found that the system of price controls in effect through most of the seventies was causing a substantial part of the damage to the dealers.

There were a number of factors which were at work, and I will not try to enumerate all of them. Some of the more important were the following:

The wholesale prices of refiners were based on their historic costs. Some refiners had lower costs than others, and these low costs were passed on, as they were required by regulation to be, to the dealers of that particular refiner. Dealers who received their supplies from other refiners were disadvantaged by that refiner's relatively higher historic costs. Thus, they were hurt seriously by competition from the dealers of low-cost refiners in a situation where the prices of each was effectively mandated by law.

The owned stations of refiners were required to maintain very low profit margins—the lower of a fixed profit margin and their historic profit margin.

Again, the independent dealers were hurt by competition from the refiner-owned stations whose margins were fixed by law.

The refiners in many instances were required to transfer to their own jobbers at very low controlled prices and at different prices than other jobbers were able to buy from other refiners.

Again, when these price differentials were passed along to the dealer network, some dealers were hurt very badly.

At the very same time, dealers were limited to their historic volumes and were deprived of the option of increasing volumes on lower margins in order to improve their situation.

Early this year, of course, President Reagan eliminated this system of regulation. The burdens it imposed on various segments of the industry have now been removed.

There is every reason to think, accordingly, that many of these harms that fell to some of the dealers during this period of time will now be eliminated.

Perhaps equally important, we have seen over the last decade very significant changes in both consumer attitudes and, partially as a result of that change in attitude, a change in consumer demand functions.

There is no doubt that consumers are far more sensitive to price at present gasoline price levels than they were at the price levels that prevailed, say, in 1970.

As a consequence, they exhibit a preference for very low margin, high volume gas-and-go types of outlets. We have seen a significant shift in that direction.

At the very same time, the high price of gasoline and the Government's environmental concerns have brought about a circumstance in which the automobile industry has moved to the production of far more intricate and far more difficult to maintain and tune internal combustion engines than we had a decade ago.

The complexity of these engines has led to the fact that a far higher fraction of maintenance and adjustment is now done by specialized automotive centers and by the automotive dealer chains than previously was the case.

Automobile repair was, at an earlier time, a highly profitable collateral activity of most of the gasoline dealers. They have lost a very major share of that market.

This bill attempts by law to freeze, as of a particular moment in time, the distribution system of a very important industry and one that is undergoing significant change for these demand reasons and for the technological reasons I have just described.

It will not result in lower prices at the retail level. It will result in higher prices. Indeed, what is proposed here is operationally the imposition of an excise tax on consumers of gasoline in order to subsidize the lifestyles and protect the investments of the dealer network.

The bill would block the slow adaptation of that segment of the industry to its changing circumstances. Accordingly, the distribution system that was frozen into place would become more and more archaic and more and more at variance with the actual market demands and cost-effectiveness that would otherwise respond to these changes.

Correcting the situation would become more and more difficult and more and more traumatic until, at long last, we got around to the painful process of deregulating a long-regulated industry, an industry whose contours had adapted to regulation with a less and less satisfactory degree of performance with the passage of time.

The creation of a daily wholesale price and its enforcement will be extremely costly. It will provoke endless litigation and regulatory intervention.

The practicality of establishing what a transfer price actually is within the contours of a single corporate entity is overwhelmingly difficult.

As I say, the combination of this daily wholesale price device with the requirements for open supply essentially force the industry entirely into a spot market mode of operation and transfer. There is absolutely no reason on Earth to think that is the most cost-effective way to run the industry. Indeed, the prevalence of longer-term buying arrangements in the industry gives every reason to suppose that the contrary is true.

Nominally, the opportunity to engage in exclusive dealing and to achieve the cost savings in inventory management, cost savings in selling costs that exclusive arrangements can afford, will be lost because the open supply requirement effectively deprives one of the parties to those exclusive arrangements of his set of benefits that led to the use of those types of contracts in the first instance.

In short, Mr. Chairman, this is a highly regulatory bill which seriously interferes with the operation of competitive markets in a circumstance in which there is no reason to think that there is any competitive defect present, and indeed, where it appears that there has been an entirely appropriate response to changing conditions of demand and technology.

The administration very seriously and strongly opposes its enactment.

Thank you. That is the end of my prepared statement. I would be happy to respond to any questions the committee may have.

The CHAIRMAN. You gave a résumé of your statement?

Mr. BAXTER. Yes, I did. I submitted the full statement for the record.

The CHAIRMAN. You want your full statement to go in the record?

Mr. BAXTER. If that is acceptable to you, Mr. Chairman.

The CHAIRMAN. We will put it in the record, without objection, at the completion of your oral presentation.

I have a few questions now.

Professor Baxter, you argued that refiners have little incentive to price their dealers out of the market. If the refiners decided it was more profitable for them to retail their gasoline themselves, might they not be tempted to drive their dealers out of the market in this fashion because of the PMPA restrictions on dealer terminations?

Mr. BAXTER. This is a very expensive way to put anybody out of a market. I cannot imagine that this is the most effective way to do that.

Dealer termination is not entirely prohibited by the Petroleum Marketing Practices Act. I just think that is an unlikely course of industry strategy.

The CHAIRMAN. Professor Baxter, do you think the consumer will benefit at all by the preservation of the full-service station by virtue of the emergency road service and other services such stations offer to the motorist?

Mr. BAXTER. I have no doubt there will continue to be an active and profitable role for some number—a number which neither I nor anyone else could possibly know—of independent dealers.

What we are seeing is not a massive elimination of dealers but a shift in the balance between full vertical integration to the dealer level and sales through independent dealers.

The reasons for that shift, I believe, have to do with the demand characteristics of high-price gasoline and a preference for gas-and-go stations and the technology of automobile servicing.

I have every reason to think the consumer will continue to benefit from the presence of precisely that number of independent dealers that a competitive economy will cause to be in existence.

The CHAIRMAN. Professor Baxter, the dealers argue that refiners are selling at retail prices that are lower than the wholesale prices they charge their dealers. Would existing antitrust laws cover this behavior?

Mr. BAXTER. No; I do not think they would.

On the other hand, I do not really believe that they are selling at lower than their costs because there is no plausible reason why they should do that.

In either event, they will make the largest amount of profit by using that distribution system which is least costly between them and the final consumer.

If they were to artificially lower their price to their owned stations, they would lose an important check on the relative efficiency of those two distribution systems. It would be contrary to their interests to do so.

There is no evidence that they are doing so, and I do not believe that is occurring.

The CHAIRMAN. Professor Baxter, what impact do you think there would be on the market if independent dealers were to disappear entirely?

Mr. BAXTER. I think that is a very difficult question to answer.

It would depend, in an important part, on the rate at which dealers disappeared and what happened as an associated phenomenon.

I do not expect that independent dealers will disappear even over a very substantial period of time. If one hypothesized that they would eventually be totally replaced by wholly owned stations over some period of time, perhaps even a somewhat smaller number of stations than had previously existed, and I think that is the pattern that we are seeing—higher volume stations operating on lower margins and somewhat less densely spaced across the landscape—the impact on the consumer would be that he continued to have available to him the least cost distribution system.

A different distribution system would entail higher costs and higher prices to the consumers. That must be so, because that is the only set of circumstances under which that disappearance would occur.

The CHAIRMAN. Thank you.

I will now turn to Senator Metzenbaum who is the chief sponsor of this bill.

Senator METZENBAUM. Mr. Baxter, in response to the chairman's question just now, you indicated that that is the only circumstance where the dealer would disappear from the marketplace.

Mr. Baxter, you are a realist enough to know that if the companies could drive out of business all of the independent gasoline station dealers and totally control the market, you must know that they are in a position to raise prices to the consumer. There is nothing to deter them from doing so.

Mr. BAXTER. I do not believe that is true at all. They would still be in very active competition with one another as they are now.

Indeed, at the present time, they have as much power at the refining level as they would then have at the retail level. One must ask the question why they are not raising prices at the refining level now to whatever monopoly price you are hypothesizing would then come into existence.

The fact that an industry integrates forward one more level in no sense changes its ability to engage in collusion or to extract monopoly profits from the ultimate consumer.

Senator METZENBAUM. The fact is that they do totally. Seven companies pretty generally control the production of the world. We do know that when one raises its price 3 cents the other raises its price 3 cents.

Mr. **Baxter**. To the extent that they have similar cost structures, of course, their prices will often, and almost always, move in the same general direction.

Seven companies is really not an accurate number.

If you take a look at refinery markets in almost any State in the United States, you will rarely find a single refiner with much more than a 10- or 12-percent share.

There are usually 10 or 12 refiners active in most areas of the United States, a far greater number than economists have ever statistically been able to associate with relatively supercompetitive profitability.

Senator **Metzenbaum**. Professor Baxter, when you came into office, there was a pending investigation of the international oil market. Where is that investigation now?

Mr. **Baxter**. The investigation is still very much in the status it was when I came. We are continuing to attempt to get information. We are encountering some objections from foreign nations.

Since it is a matter under investigation and involves foreign policy problems as well as antitrust problems, I prefer not to comment on it in great detail.

Senator **Metzenbaum**. When can we have a report? It was promised in the previous administration. It is your responsibility in the present administration. The public is entitled to have the results of that investigation, even if incomplete.

When can we get some public report as to what the investigation has disclosed so far?

Mr. **Baxter**. I do not really know the answer to that. That would only be possible if we decided to close the investigation. Then it would be possible to make a report.

So long as the investigation remains open and we have hope that it can be brought to some sort of fulfillment, then, of course, it would be our position that we would be unwilling to make disclosure of information involved in a pending investigation.

We have from time to time wondered whether we should not regard ourselves as effectively stymied in this matter. To this date, however, we have been unwilling to decide to close that investigation.

Senator **Metzenbaum**. How many years has it been going on now?

Mr. **Baxter**. I am not really sure how long it went on before I got here, Senator. I think about 3 years, so it is into its fourth.

Senator **Metzenbaum**. It started in the summer of 1977. It is now over 4 years. Don't you think the American people have a right to expect more of their public officials than to have it delayed interminably?

Mr. **Baxter**. As I say, they are entitled to expect that we do the best job we can. In this circumstance, it means obtaining documentary evidence that other nations are unwilling to see delivered to us.

We have had the State Department involved in the episode. Our choices are either to continue with a very difficult international problem, as we have been, or simply to abort the investigation.

It is not clear to me that the public would be better off if we simply aborted the investigation, but we will reconsider that possibility if you think that is clearly the preferred route.

Senator **Metzenbaum**. I do not think you ought to abort the investigation; I think you ought to complete the investigation and report to the American people as much as you have—instead of suggesting that I suggest the abortion of it.

The FTC has dropped the cases against the oil companies. You are doing nothing in this area. The American people think that the oil companies control this Government, and there is reason for them to believe so.

Mr. Baxter, I think you have a responsibility to come forward with a report with at least as much as you have done on this subject. To do less than that, I think is irresponsible on your part as well as your predecessors.

I just think that the American people have a right to know what you have been spending the taxpayers' dollars for and what you have concluded. What governments are not making information available to us.

It is not that you ought to abort the investigation. You ought to report to the American people what you have found. You certainly have found some things out in over 4 years.

Mr. Baxter, your opposition to the bill seems rooted in theories. I am afraid it has possibly kept you from observing some of the actual realities of the marketplace.

We have had witness after witness come before us—not only now but in the House and previous hearings of this committee before this year—talking about how the independent gasoline stations have been forced to close their doors and have been squeezed up against the wall.

You suggest that refiners would not engage in predatory schemes directed at their dealers because independent dealers are more closely akin to partners in distribution than to competitors.

If even a third of what we have been hearing over the past several years is taking place, I guess I would not want to have partners like that. That means that they would be squeezing me up against the wall and forcing me out of business as an independent operator.

They have engaged in actions such as tripling rents, abrupt changes in credit arrangements, refusals to maintain equipment, and similar kinds of actions.

Would you suggest that is the action of a sympathetic partner?

I, myself, have been in a gasoline station. I said to the man: "How come your price is so much more than your competitor across the street selling the same brand?" He told me that the parent company owned the station across the street, and they were selling to him at a price higher than that which they were selling at retail.

How can you be here and suggest that these refiners can be trusted partners when they are actually underselling their own dealers in many instances and when they have engaged in practices of putting on pressure by reason of credit arrangements and tripling rents? How can you suggest that there is not a problem and that they can instead rely upon their partnership with the oil companies? I have difficulty in understanding that.

Mr. **Baxter**. I am not suggesting that the dealer under many circumstances will not find that his operation is no longer economic and that he is squeezed out.

What I am suggesting is that the refiner has every incentive to market through the least cost distribution system.

It is quite clear that the least cost distribution system in a larger fraction of instances than was previously the case is a channel other than the independent dealer.

We are witnessing a change in technology and demand characteristics which are causing that shift to occur.

I am suggesting that it is not a shift that is being dictated by the refiners. It is not a shift that is particularly in the interest of the refiners. The market is responding to those changed circumstances.

I am suggesting that it is very unwise for the Government to try to freeze a distribution system into place when it no longer corresponds to the dictates and cost structures of the marketplace. That is precisely what this legislation would do.

People who have made investments in a technologically shifting market would always like to have those investments protected. They can be protected at the expense of the consumer, to be sure. It constitutes a kind of covert welfare system for investors in the shifting technology.

If the Government is going to take action of that kind, it seems to me that the excise tax they are levying on consumers and the proceeds of that tax they are paying over to the beneficiaries of the scheme at least should be made explicit.

Senator **Metzenbaum**. What evidence do you have that by operating through the independent dealer there is any cost to the consumer? What evidence do you have that these are so-called technological changes dictated by the marketplace, as contrasted to the evidence which is readily available that the parent companies have been using these tactics literally to close up their independents and to open competitive stations which are owned by the corporation.

That is not technological; that is just plain, callous economic squeeze.

Mr. **Baxter**. That is a response to a technological change.

Senator **Metzenbaum**. What is the technological change; tell me?

Mr. **Baxter**. The technological change is primarily a change that has occurred in the internal combustion engine. If you open the hood on your car and look, the engine that is inside is a very, very different engine than was inside not very long ago.

There are microprocessors in there that are associated with the recirculation of the gases out of the manifold back into the cylinders. There is an enormous variety of extremely complex changes in tolerances and carburetion. They have to be serviced—at least consumers by their behavior exhibit that they prefer to have them serviced—at specialty automotive centers and at their automotive dealers.

The fraction of servicing that has occurred at the retail stations has fallen quite dramatically.

Senator **Metzenbaum**. I think you are pulling my leg when you tell me that these are technological changes that have to do with something under the hood.

When I go to a gasoline station, I cannot get them to open the hood if I beg them to do it or if I pay them $10, or $20. They do not know about anything that is under the hood.

They make me pump my own gasoline. They make me walk to the window and pay for my gasoline. You think that is a great technological change that has been brought about? All they have done is make me do all the work while they make the profit.

Tell me what technological changes dictate squeezing an independent who might wipe off my windshield, and who might put air in my tires, and who might do something for me?

Is this a technological change just because they made some changes under the hood? You are kidding me.

Mr. **Baxter**. No, I am not, Senator.

The fact is that an important source of revenue for the independent dealer that used to supplement the profits he made on the sale of gasoline has now largely disappeared.

Senator **Metzenbaum**. What has disappeared? The independent cannot make a profit running a gasoline station?

Why do you think all these people are in the room? They are trying to run them. They are making a living for their families. They are not all lobbyists for the API. Some of them are here as independent dealers who are concerned that the oil companies are squeezing them out of business, and it is their only source of income.

Mr. **Baxter**. I have no doubt that this legislation would be good for the independent dealers.

Senator **Metzenbaum**. And bad for the country and the consumers?

Mr. **Baxter**. Yes.

Senator **Metzenbaum**. You really think that?

Mr. **Baxter**. Yes.

Senator **Metzenbaum**. I think, Mr. Baxter, that you are totally unrealistic. Maybe you have been too close to those hallowed halls of ivory that you teach in to understand what is happening in the marketplace out here. These are people fighting for their economic lives.

They are turning to their Government to ask for some assistance. Instead, the chief spokesperson for the Antitrust Division of the Department of Justice is here saying: "It is your problem. Let them squeeze you out. We are not going to be on your side at all."

I think that is really what is happening in this country.

Antitrust was a concept that came about under a great Republican Senator from my own State years ago. Unfortunately, it no longer is on the side of the people. It is more on the side of business these days and more on the side of the oil companies against these independent businessmen who are trying to just make a living—that is all.

Mr. **Baxter**. No; It is on the side of efficient manufacturing and efficient distribution and on the side of the consumer. It does oppose subsidization of an industry and attempts to freeze it in place and prevent the changes that would otherwise come about by the operation of a free market.

Senator METZENBAUM. How does protecting an independent marketer represent subsidization? Isn't the contrary actually the fact?

What is happening is that the company station is being subsidized by the oil company.

When the Department of Energy made its study, they failed to take into account what was happening with fixed costs or capital costs. They just compared the raw data that was submitted to them by the companies and did no independent investigation on their own. They did not even have the resources available to do it; or if they did, they did not use them.

When you say that there is subsidization that would be eliminated, the opposite, I believe, is the fact.

Mr. BAXTER. I did not say there was at present any subsidization. I do not believe there is at present any subsidization.

Senator METZENBAUM. I am sorry; I did not hear your answer.

Mr. BAXTER. I said I did not say that there was some subsidization going on at the present time. Indeed, quite the contrary, I said that there was no subsidization going on.

It is not in the interest of refiners to subsidize their own owned stations. If their own owned stations needed to be subsidized, if there were higher costs than those of the independent dealers, it would be profit maximizing for the refiners to distribute through independent dealers primarily as they did for many, many years when that was the fact. It is no longer the fact to the same degree.

Senator METZENBAUM. Do I interpret your remarks to suggest that the decline in independent dealers has in part come about by reason of changes in consumer preferences?

Mr. BAXTER. Yes.

Senator METZENBAUM. I do not quite understant that, because I do not understand how the independent dealer in your mind is incapable of delivering high volumes of gas with less service if that is what the consumer wants.

The company stations that I see are the ones that give the least amount of service at the moment. They are the stations that really only sell at less where there is subsidization from the parent company.

I do not understand how you make this argument or what you use to support the argument that it is based upon consumer preference.

Wouldn't I rather deal with the owner of the station than I would with some young man or woman who is just collecting my money?

Mr. BAXTER. Of course, I have no idea what you would rather do, Senator. I do know that American consumers in enormous numbers are voting with their feet. They are voting for gas-and-go stations that pump very large volumes and charge very low margins.

They are voting with their feet for lower priced gasoline—notwithstanding the fact that they have to give up some of these traditional services in order to get it.

That is in major part what is dictating this shift.

The loss of automotive-service revenues to the independent dealers is another factor.

Senator METZENBAUM. How would you answer a gasoline station dealer who says to you: "Mr. Baxter, it costs me $1.17 a gallon for my product. My competitor across the street is selling it for $1.17, or $1.19, or $1.20."

It is impossible for them to cover their fixed costs, and their labor costs, and their utilities, and so forth. It is a company-owned station.

He says: "Frankly, I do not know what to do, Mr. Baxter. What can I do about that?"

Would you just tell him that is part of the competitive world in which he lives?

Mr. BAXTER. Yes; I think I would.

Senator METZENBAUM. If he said to you: "Mr. Baxter, that is not competition. What they are doing is using money from another part of their economic operations in order to drive me out of business. In fact, they have come to me and offered to buy my station for something less than it is actually worth."

Isn't that unfair competition, Mr. Baxter? Can't you help me in some way?

Mr. BAXTER. No; it is not unfair competition.

The idea of one piece of a competitive enterprise subsidizing in some sense another piece of the same competitive enterprise is simply a misunderstanding of the process.

Senator METZENBAUM. Do you think that is proper to do?

Mr. BAXTER. I do not think it occurs. I do not think it is a meaningful concept.

Senator METZENBAUM. I am not asking you whether you think it occurs.

I am saying: Let us assume there is a company-owned station selling it for $1.17. The independent pays $1.17. That is obvious that there is some element of unfair competition there, because company-owned stations certainly have some expenses.

You do not think that is an impropriety for the company to be subsidizing that company-owned station as against its independent dealer across the street?

Mr. BAXTER. There is no possibility of a company subsidizing its wholly owned station.

Senator METZENBAUM. Why do you say that?

Senator SPECTER. Would the Senator yield?

Senator METZENBAUM. Sure.

Senator SPECTER. As I understood you, Mr. Baxter, you were saying that factually you do not believe that a company-owned station is selling the gasoline at a price less than the company is selling to an independent?

Mr. BAXTER. No.

I can imagine that might occur.

All I am saying is that if a refiner owns a set of stations and they are part of a single enterprise, that enterprise will try to maximize its profits, which involves selling at the highest price it can sell at and it involves keeping its costs as low as it can.

It will not distribute through wholly-owned stations if there are independent dealers around who can operate stations more cheaply than its own employees can operate stations.

There are certain real advantages to using an independent dealer. He is on the scene. He has an incentive to manage the station effectively. It is an incentive that is quite difficult to create in a salaried station manager who is typically present.

There is no answer in principle as to which distribution system is going to be the least-cost distribution system.

What I am saying is that the refiner has every incentive in the world to use the least-cost distribution system.

Senator SPECTER. I do not disagree with any of the principles you have articulated, but this is the one factual matter which has troubled me.

When Senator Metzenbaum was exploring it, that is when I asked if he would yield, because I had thought that you disagreed with the underlying factual basis.

I have been told on two occasions by my own service station where I have bought gasoline, that the company-owned stations sell for less than the company will sell to an independent.

Mr. BAXTER. With the same refiner?

Senator SPECTER. Yes.

The same brand of gasoline is being sold for $1.25 by a company-owned station, and it costs $1.30 for the independent to buy the same gasoline. I think those were about the prices.

Does that factual situation surprise you?

Mr. BAXTER. Yes; that factual situation does surprise me.

Senator SPECTER. If that factual situation is correct, would you say that is unfair competition?

Mr. BAXTER. No. I would go looking for some explanation. I would not expect it to endure. If I really saw that situation persisting over substantial time horizons, it really poses something of an economic mystery.

Senator SPECTER. Yes.

Mr. BAXTER. One would want to find out what was motivating the refiner to behave in a way which obviously was not profitable or profit maximizing for the refiner.

Senator SPECTER. One possible motivation would be to drive the independent out of business.

Mr. BAXTER. If the independent is less efficient than the wholly owned station, there is no need to engage in that kind of behavior. He will disappear from the marketplace in any event without any such artificial price maneuver.

Senator SPECTER. Some of these fellows are pretty tenacious. They survive in a variety of ways or maybe it takes longer.

Mr. BAXTER. As long as they can survive on the prices that are profit maximizing at the refinery level, the refiner should be delighted to have him around.

Senator SPECTER. That is the one factual allegation which has been called to my attention which troubles me greatly. It may be that part of what we ought to explore factually, is whether that is correct.

Mr. BAXTER. Let me contrast, if I may, that fact situation with a slightly different fact situation where the station across the street is selling for $1.17 to the final consumer. The independent station across the street has to pay $1.15. He says: I cannot possibly survive on the 2-cent margin which is all I have left.

Now, you see, we do not know the shadow price at which the refiner transferred to the refiner-owned station across the street, and the concept of an intracorporate transfer price is virtually meaningless in any event.

There are all sorts of perfectly plausible unobjectionable and competitive explanations for why that set of circumstances might exist.

If the company across the street—the refiner-owned station—is selling to consumers at a price below the price at which the independent can buy from the refiner, I would find that a startling set of facts.

Senator SPECTER. And beyond finding it a startling set of facts, would it be your opinion that is unfair competition?

Mr. BAXTER. I would feel that I was confronted with a mystery of sorts. I would want to find out how long that situation had prevailed.

I can easily imagine it being a short-term promotional activity.

Senator SPECTER. If it were not? If it were long-term?

Mr. BAXTER. If it were long-term, then I would want to find out what the refiner thought he was doing because he is not pursuing a profit-maximizing strategy.

Senator SPECTER. You would be looking for an explanation which might not be unfair competition.

Mr. BAXTER. But might be.

Senator SPECTER. It also might be fair competition.

Mr. BAXTER. It is conceivable.

Senator SPECTER. In the absence of some good business reason to be doing that.

Mr. BAXTER. Yes.

Senator SPECTER. I would hope that we would explore that further, because I think that is the nub of a great deal of what I have heard on this subject.

Thank you very much, Senator Metzenbaum.

Senator METZENBAUM. Mr. Baxter, I would say that I think Senator Specter has indicated clearly why he made such an able district attorney. I thought that was a, very good cross examination.

Mr. Baxter, as I get your testimony and your responses to Senator Specter, what you are really saying is that you would always look for some explanation; but you would never think that the oil company might be guilty of unfair competition until you had explored and investigated and inquired and examined and gone through a host of thought processes—maybe including a 4-year investigation in your department. However, you would never think that it may have been unfair competition for the oil company to be selling at the same or even 2 cents a gallon more.

If they sold 100,000 gallons a month, that would make them $2,000 to cover all their expenses which obviously they cannot do.

The fact is that in no way do you recognize that the increasing of rents and tripling of rents and the cutting off of credit and numerous other procedures that have been used by the oil companies against the independent marketers which have resulted in a tremendous decline in the number of independent marketers in this country is a result of unfair competition until you have explored it ad infinitum and there is no longer one independent dealer in the country.

Mr. BAXTER. There are perfectly plausible explanations for all those phenomena.

I believe very strongly that companies will do whatever they can and bring great ingenuity to bear and be as ruthless as the law will permit in order to maximize their own profits.

Senator Specter suggested a situation to me that cannot possibly represent profit maximization on the part of the refiner.

All the situations you are talking about are entirely consistent with profit maximization on the part of the refiner.

Senator METZENBAUM. If we were to bring you five separate cases from throughout the country of examples exactly as Senator Specter has described, would it change your opinion as to the need for this bill in order to protect the independent dealer?

Mr. BAXTER. I would have to look at them very carefully.

If you are talking about testimony to the effect that five such——

Senator METZENBAUM. I am talking about facts. I am not talking about testimony.

If we bring you five factual cases that the oil companies do not deny, would you then switch positions and be for this bill?

Mr. BAXTER. If they were situations that persisted over a long period of time, it is a conceivable possibility.

Senator METZENBAUM. That is pretty good. We are going to do that.

You indicate in your testimony that the antitrust laws provide an adequate remedy to the independent marketer.

Given the complexity of antitrust litigation and the cost involved in bringing such suits, do you really think that an individual can go forward with a meaningful antitrust action against a major oil company?

Mr. BAXTER. It would be very difficult for an individual to do, but we have rules about class actions. A dealer network is exactly the kind or set of individuals who are in the optimum position to take advantage of those rules. I see no reason whatsoever why they could not do so.

We have a large number of examples where they have.

Senator METZENBAUM. There is an outfit called the Federal Trade Commission. They brought suit against four or eight oil companies. I do not remember which.

After a period of years and years, they gave up the suit because they could not even get their subpoenas responded to.

Mr. BAXTER. That had a great deal to do with the fact that they did not have a coherent theory about what the oil companies were doing wrong when they started.

Senator METZENBAUM. And you think that there was no basis for the suit at all?

Mr. BAXTER. There was no basis for the suit they brought because it was not based on any coherent theory of what the oil companies were doing wrong.

When you have a case like that, nobody knows what documents they want to look at. The document demands become longer and longer and the expenses of the parties of complying become greater and greater.

You can tell from the outset that you are headed for a quagmire some number of years down the road.

Senator METZENBAUM. Does the antitrust department tend to investigate any of the claims being made by the dealers in this area in such matters as Senator Specter has alluded to and I have alluded to? Do you expect to do any independent investigation?

Mr. BAXTER. I am not aware that we have received any complaints from dealers, although perhaps we have. I have not seen any.

Senator METZENBAUM. Would you investigate them properly if you did?

Mr. BAXTER. It would depend on what they said and whether they had some coherent theory or any evidence that there was any violation of the antitrust laws.

Senator METZENBAUM. Does Mr. Favretto work for you?

Mr. BAXTER. Mr. Favretto used to work for me.

Senator METZENBAUM. Was he fired?

Mr. BAXTER. No. He left to go into private practice—a move which I very much regret.

Senator METZENBAUM. Is he an able man?

Mr. BAXTER. Yes.

Senator METZENBAUM. When he testified for the division in the House that there are no remedies under existing antitrust laws for the kinds of grievances independent dealers have, you are taking issue with that and saying he was wrong?

Mr. BAXTER. No, not at all.

His testimony, I think, had to do with this question of remedies against one's retailer for charging a higher shadow price to a refiner-owned station or a lower shadow price to an owned station than the delivered price to the independent retail outlet.

Limited to that context, I would agree that there is no antitrust remedy, but dealers have a large number of grievances, some of which might well involve antitrust violations.

Senator METZENBAUM. Mr. Baxter, you theorize that the divorcement provisions of the bill will injure consumers. Has it not been the experience in Maryland, after they implemented their divorcement bill, that dealer margins have fallen in Maryland relative to other nondivorcement States, that tax adjusted prices are lower in Maryland compared to other States, and that the number of dealers going out of business is far less in Maryland.

How has any of this caused injury to the consumer?

Mr. BAXTER. I do not accept those facts.

Senator METZENBAUM. Then will you tell me what you know that is contrary? If you do not accept them, then you must know something that I do not.

Mr. BAXTER. I know the nature of the study that was involved. I know the difficulties with making studies when asked to do either cross-sectional studies, comparing Maryland with other States, in which case one has to make a large number of adjustments for cost differences, distance from refinery center, and so on. Or one has to engage in time series analysis over a long period of time.

Then one would have to take account of a large number of other circumstances—changing costs accrued and changing costs of a variety of kinds.

The Maryland study simply was not a study that took any of those necessary precautions.

Senator **Metzenbaum**. I know, but you told me you did not accept the facts.

Tell me: Am I wrong when I say that dealer margins have fallen in Maryland relative to other nondivorcement States?

Mr. **Baxter**. No one is able to tell you whether you are wrong, Senator, because there was not a competently done study.

Senator **Metzenbaum**. You told me I was wrong.

Mr. **Baxter**. No, I said I do not accept the facts.

Senator **Metzenbaum**. You do not accept the fact that tax-adjusted prices are lower in Maryland compared to other States?

Mr. **Baxter**. That is a statement that would be relatively easy to establish or refute, but it does not tell us anything about the effect of the legislation.

Senator **Metzenbaum**. And you are not willing to accept the fact that the number of dealers going out of business is far less in Maryland? That is an easy one to check.

Mr. **Baxter**. Again, it would be relatively easy to check, but it tells us nothing about the effects of the legislation.

Senator **Metzenbaum**. You said that the consumers are hurt. How do the consumers get hurt?

Mr. **Baxter**. The consumers would get hurt because you would be forcing the industry away from the least-cost method of distributing gasoline.

Senator **Metzenbaum**. What factual basis do you have that it is the least-cost method of distributing? What is your factual basis?

You keep using that phrase. Where did you get your information to tell us it is the least-cost method?

Mr. **Baxter**. The companies that are involved in the industry have every incentive to utilize the least-cost method.

Senator **Metzenbaum**. That is motivation; that is not fact. Give me your facts. You said it is the least-cost method of distributing. Now tell me what your facts are—not what their incentives are.

Mr. **Baxter**. There is no reason to think that they are not behaving in that way until there is some evidence to the contrary, and there is no evidence to the contrary.

Senator **Metzenbaum**. You have made a representation that it is the least-cost method of distributing. Now you tell me they have incentives. You tell me there is no reason to believe. All of that, to quote you, Mr. Baxter, is rubbish.

What about the facts? What are the facts to support the statement you just made that it is the least-cost producing method of operating to have the companies be able to make the distribution.

Mr. **Baxter**. That is rather like asking why a glass falls from a table to the ground.

Senator **Metzenbaum**. No; it is not like that at all, Mr. Baxter. What are your facts?

Mr. **Baxter**. The answer is that there is a perfectly coherent body of theory that has been validated in literally thousands and thousands of instances. Until there is some suggestion that the glass jumped up from the floor onto the table rather than the converse, there is no reason on Earth to suppose that what is going on in this industry is not what we see going on in those dozens of other industries where there has been great documentation.

The only empirical study that I am aware of on the particular topic we are talking about today—one, incidentally, with which I would find some problems too, but there will be a gentleman following me who is much better able than myself to address the details of that study—shows that we do, in fact, observe in this industry exactly what economic theory would predict that we would find.

Senator **Metzenbaum**. What you are really telling us is that your whole position on this bill is based upon theory, reason to believe, and a glass dropping off the table.

Part of that glass dropping off the table also has to do with the fact that the refiner has a strong incentive to have less dealer-operated stations and to own all of the facilities from the production to refining to distribution pipelines all himself. That also is an economic theory, and he has reason to want to do that. Yet you do not seem to want to concern yourself about that at all.

Mr. **Baxter**. I have no idea why his incentive to do that is so different in 1981 than it was in 1970. If that is in the interest of refiners, why didn't they do that in 1970, or 1935, or 1910, for that matter?

We are talking about a change that has occurred in the last few years. We cannot explain the change that has occurred in the last few years with factors that have always been present. One must find some other change in the last 10 years which has caused things to move in this direction.

Senator **Metzenbaum**. They were doing it according to the information I have, although I cannot support that. I am told that by a staff member.

Beyond that point, it seems to me that we have to be realistic about the fact that up until the last few months there was such a shortage of supply that the dealers had a very persuasive reason to do it—that is, to be able to take advantage of the entire economic stream from the beginning to the end and make all of the profit rather than let anybody else share in it. That was a pretty good reason.

Mr. **Baxter**. There was no shortage through the fifties or sixties. The oil companies established independent dealer networks.

Senator **Metzenbaum**. I understand that.

Mr. **Baxter**. What is it that has changed that has suddenly made it desirable for them to operate to a greater degree through wholly-owned stations? Something must have changed.

Senator **Metzenbaum**. Certainly.

If you only have a certain number of barrels of oil a day to distribute and you can control the entire distribution and make the profit all the way along at every step of the line and you are going to sell all of your product, which was the case up until the last several months, then you do have a very strong reason—a reason that did not exist in the fifties and sixties when there was plenty of oil available.

It was only recently that we started talking about this shortage. That is when the pressure accelerated.

Mr. **Baxter**. There is no shortage in petroleum. Indeed, the only time you can have a shortage is during a period of price control.

There is now available all the petroleum anybody wants to buy at presently prevailing prices. That was true to exactly the same degree in the fifties and sixties.

Senator **Metzenbaum**. Was it true a year ago?

Mr. **Baxter**. During the period of price controls, of course, that ceases to be true. You can create real shortages with price controls.

Senator **Metzenbaum**. It was not always true.

When the dealers were feeling the greatest squeeze, there was a shortage wasn't there? Tell us the reason.

Mr. **Baxter**. There was a pattern of shortages during the period of government price controls and allocations. However, those factors are now gone.

Senator **Metzenbaum**. We are not talking about that. We are talking about all of the dealers who have been squeezed out and the ones who are continuing to be squeezed out.

You said that what had happened in the seventies, and we pointed out to you what had happened, was that there was a shortage where one did not previously exist.

Mr. **Baxter**. There were price and allocation controls and Government regulation. Those are over now. I thought the question was whether we need to pass this bill now.

Senator **Metzenbaum**. Mr. Baxter, there is an instance documented by the Service Station Dealers Association where Chevron prohibited one of its dealers from buying Chevron gasoline from a Chevron jobber for 4 cents less than what the refiner was charging.

Would you approve of that kind of a closed supply arrangement?

Mr. **Baxter**. I am sorry, Senator. I tried to listen, but I did not hear it all.

Senator **Metzenbaum**. I understand.

The Service Station Dealers Association documented an instance where Chevron had prohibited one of its dealers from buying Chevron gasoline from a Chevron jobber for 4 cents less than what the refiner was charging.

That is a documented case. It is not just testimony; it is a documented case I am told.

Assuming it to be factual, how would such a closed supply arrangement benefit the consumer?

Mr. **Baxter**. I have no idea. I do not understand what is going on in that situation.

Senator **Metzenbaum**. You do not understand what justification, if any, there would be for such a prohibition?

Mr. **Baxter**. Or why it would be in the interest of the companies involved.

Senator **Metzenbaum**. How do consumers benefit, generally speaking, then, from exclusive dealer arrangements that prohibit the dealers from obtaining supplies at the cheapest possible prices?

Mr. **Baxter**. It creates a situation where a dealer does not have to maintain so large an inventory and where regularly scheduled refilling of his tanks is possible. In short, it reduces transaction costs and selling costs.

Senator **Metzenbaum**. Therefore, you think the consumer benefits?

Mr. **Baxter**. Yes.

Senator **Metzenbaum**. Thank you very much, Mr. Baxter.

Mr. **Baxter**. Thank you, Senator.

[Material follows:]

PREPARED STATEMENT OF WILLIAM F. BAXTER

Mr. Chairman and Members of the Committee:

I am pleased to be here today to present the views of the Department of Justice on S. 326, the "Small Business Motor Fuel Marketer Preservation Act of 1981." The Department of Justice strongly opposes enactment of this legislation.

Before turning to the specific grounds for our opposition, I would like briefly to outline some of the bill's major provisions. Section 2, generally referred to as the "divorcement" provision, would prohibit major refiners from operating retail gasoline stations. The bill would also require establishment of a daily wholesale transfer price for motor fuel and, with certain limited exceptions, would require a supplier of motor fuel to sell or transfer fuel only at that price, including sales to independent wholesale purchasers or to any person "related" to the supplier. In addition, the bill's so-called "open supply" provisions would prohibit any person from restraining or interfering with dealers wishing to purchase, store or sell motor fuel purchased from another supplier.

The bill would be enforced by the Federal Trade Commission, and violations of certain provisions would be subject to fines. In addition, persons "directly affected" by the violations of others would be permitted to sue for damages and injunctive relief. Finally, the bill would require refiners to report certain cost and product information to the FTC to assist enforcement, and would authorize promulgation of implementing regulations by the Small Business Administration and the FTC.

If enacted, S. 326 would substantially restructure the retail petroleum industry. Legislation which would bring about the severe disruption inherent in such a restructuring should be enacted only where there is convincing evidence that there has been a serious failure of the competitive market to serve the consumer efficiently. No such failure is evident. Moreover, even if some market failure had been demonstrated, S. 326 could only exacerbate the problem. As I will discuss, S. 326 is likely to have severe anticompetitive effects, and the Department of Justice strongly opposes its enactment. 1/

THERE IS NO NEED TO ENACT S. 326

S. 326 addresses a perceived problem at the retail level of the petroleum industry. Recently, many independent dealer-operated service stations have been going out of business, while the number of refiner and jobber-operated gas-only outlets has increased. Citing these developments, some industry observers have contended that there exists a competitive defect in the retail petroleum industry which, unless remedied, may result in the elimination of independent service station dealers as a group. Such a result

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1/ A corresponding bill, H.R. 1362, has been introduced in the House. That bill contains all the provisions of S. 326 and, in addition, prevents a small or independent refiner from exceeding a specified level of direct retail sales of motor fuels. Deputy Assistant Attorney General Richard J. Favretto testified against that bill on March 31, 1981, before the Subcommittee on Energy, Environment and Safety Issues Affecting Small Business of the House Committee on Small Business. I have submitted a copy of that testimony to the Committee for its convenience.

could be viewed as unfair both to small business interests, and to consumers of motor fuels who, it is asserted, might be forced to pay higher than competitive prices. If this trend could be attributed to a competitive defect in the retail gasoline market, then concern would be justified, and the Department of Justice would share that concern.

The most frequently expressed fear regarding the competitive structure of the retail domestic petroleum industry is that it is somehow anticompetitive or "unfair" for refiners or jobbers to operate retail stations that compete with the independent service stations that they supply. Proponents of this view suggest that integrated firms could favor their retail operations by raising the prices charged independent dealers, by transfering gasoline supplies to their own retail outlets at lower than market prices, or by some combination of these two methods. Thus, the argument goes, such conduct could provide the integrated firm's retail outlets with a cost advantage over their independent rivals.

In order to determine whether conduct of this nature was occurring, Congress enacted Title III of the Petroleum Marketing Practices Act, 2/ which directed the Secretary of Energy to conduct a study of possible "subsidization" of retail gasoline dealers by major refiners, and whether such subsidization, if it occurred, was predatory or posed a threat to competition at that level.

2/ 15 U.S.C. § 2841 (1976).

The Secretary's Final Report to the Congress, 3/ published in January 1981, describes DOE's study of the subsidization issue. DOE reviewed data collected at retail outlets in five Standard Metropolitan Statistical Areas for the year 1978, and documents subpoenaed from nine integrated oil companies. The Report concluded that the information studied revealed no evidence of subsidization at the retail level as part of a predatory campaign directed against independent dealers. 4/ The Report suggested instead that the decline of independent dealers was attributable to other causes, including changed consumer preferences, altered market conditions and DOE price and allocation regulations. 5/

Whatever criticism one might make of the DOE analysis, the Report's ultimate conclusion cannot be ignored. After extensive empirical and documentary investigation, the Department of Energy found no evidence of predatory subsidization in the retail petroleum industry. This conclusion is reinforced by the fact that integrated refiners have no apparent incentive to engage in predatory behavior intended to drive independent gasoline retailers out of business. Generally, if a firm engages in predatory conduct it does so in the hope of driving its competitors from the market. Once its

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3/ Office of Competition, Department of Energy, Final Report: The State of Competition in Gasoline Marketing (As required by Title III of the Petroleum Marketing Practices Act) (January 1981) (hereafter referred to as "Report").

4/ Report at Preface; see generally chapter III.

5/ Report at Preface; see generally chapter VI(D).

competitors have been driven out, the firm would then hope to increase its prices to monopoly levels. In other words, the predator loses money in the short run in the hopes of making higher profits in the long run.

However, we believe it is unlikely that a predatory scheme intended to eliminate independent gasoline retailers would be attractive to any refiner. First, independent retailers are more closely akin to its partners in distribution than to competitors. Second, any such effort would not be effective, because the retail level of the industry is workably competitive and, across the continental United States, the market share of any particular refiner in any given state is relatively low. 6/ Thus, even if an integrated refiner could drive some independent dealers out of business, it would still have to compete at the retail level with the dealers of other refiners. Moreover, if such a refiner attempted to raise its retail prices above competitive levels, new dealers would enter the market and prevent the predator from earning monopoly profits. Hence, any campaign of predation would not only involve near term losses but would fail to recoup those losses in the long run.

In any event, even if predation were occurring in the retail gasoline market, additional legislation would be unnecessary. Rather, the Department believes the antitrust laws provide an adequate remedy for such conduct. For example, attempts to drive

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6/ See VII Lundberg Letter No. 2, at 6 (Jan. 16, 1981).

independent dealers out of any retail gasoline market may be unlawful under the Sherman Act. In such situations, treble damages would become available to those injured, and the offending firms would be subject to civil and criminal prosecution. In addition, the antitrust laws would prohibit a wide variety of other possible conduct which might unreasonably restrain or substantially lessen competition. Moreover, unlike the divorcement approach, the antitrust laws provide effective remedies for predatory conduct without requiring extensive regulation of the day-to-day responses to business conditions that are necessarily diverse, local, and typically subject to rapid change, and which are therefore inherently impervious to effective oversight by cumbersome administrative or other regulatory devices. Rather, the antitrust laws are intended to promote efficient business behavior by preserving the flexibility of businesses to respond to changing market conditions, which inevitably these businesses are in the best position to know and assess.

Finally, the Department of Justice agrees with the Department of Energy's conclusion that factors other than predatory subsidization are the cause of the loss of some independent gasoline retailers. In its Report, DOE identified two potential explanations for the problems of independent dealers, including DOE regulations, which disadvantaged independent dealers, and changes in consumer preferences. The Department believes these factors account for most of the perceived plight of independent dealers.

As the Report notes, DOE's price and allocation regulations imposed significant burdens on independent dealers. 7/ Three effects resulted from the imposition of the pricing regulations alone. First, the regulations required refiners to set wholesale gasoline prices, in part, on the basis of their average crude oil acquisition costs. Independent dealers limited to high-cost base period suppliers were at a significant competitive disadvantage as, during periods of adequate supply, such outlets were forced to reduce their profit margins to exceedingly low levels in order to compete with those dealers supplied by low-cost suppliers.

The second problem resulting from the price controls was caused by a regulation that limited company-operated stations to the lesser of their historical markup or a fixed markup. Although the independent dealers were allowed the full fixed markup, the apparently greater degree of freedom was useless to them in the many situations in which the independent dealer faced competition from a low markup company-operated outlet. To the extent that DOE regulations forced prices by the majors below a level at which the independents could earn a competitive rate of return, they may have generated losses which the majors, but not the independents, could sustain over the period.

7/ Report at Chapter VII.

A third distortion resulted from a regulation which froze the differential between the prices at which a refiner sold to jobbers relative to the price charged to dealers to levels prevailing in 1973. Insofar as the price controls applicable to jobbers resulted in those firms passing all or part of the cost advantage attributable to this freeze on to their customers, jobber-operated stations may have experienced lower costs than the independent stations.

In addition to these pricing problems, DOE's allocation regulations significantly disadvantaged independent dealers by limiting their access to additional gasoline supplies beyond their historical levels, thus depriving them of any possible opportunity to increase their volume in order to compensate for their inability to raise prices. However, the regulations permitted refiners to open new company-operated stations, thereby making new supplies available for retail sale and reducing the amount of gasoline available to dealer-operated stations during shortage periods. Thus, the independent dealers experienced a further competitive disadvantage as a result of their inability to increase their allocations due to the stricter standards applicable to existing stations.

As I am sure you are aware, shortly after taking office President Reagan ordered substantial decontrol of the petroleum industry and elimination of DOE's gasoline price and allocation regulations. In this decontrolled environment, many of the burdens that disadvantaged independent dealers have been removed, and their ability to respond to market forces should be improved significantly.

The second and related non-subsidization factor suggested by the Report as an explanation for part of the loss of sales experienced by independent dealers is the recent change in consumer preferences in the retail gasoline industry -- a phenomenon which does not indicate a competitive problem but, rather, reflects the normal operation of a competitive market. 8/ As DOE correctly noted, the present trend in gasoline retailing is toward self-serve and gas-only stations. The retailing strategy traditionally utilized by most independent dealers is based on promotion of brand names, sales of non-gasoline automotive products, and provision of repair services. However, this type of marketing strategy is not necessarily consistent with the recent increase in consumer price consciousness, and the trend has been away from the traditional franchising approach and toward high-volume, low-overhead stations. Inasmuch as the allocation controls significantly limited an independent dealer's ability to obtain increased allocations, these dealers found it difficult to respond effectively to the demand for low-price gasoline from gas-only operations. The Report found that, at the same time, the demand for repair services

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8/ Report at 192-97.

provided by independent dealers has declined in the face of increasingly complex automobiles and the growth of specialized repair centers. 9/

To sum up my observations thus far, the Department of Justice does not believe that a persuasive case has been made for enacting legislation such as S. 326. We are not aware of any credible evidence that either predation or subsidization is occurring at the retail gasoline level, and we do not deem it likely that predatory conduct directed at independent dealers could succeed. In any event, the antitrust laws provide an adequate remedy for any predatory or unreasonably anticompetitive conduct that may hereafter be identified in this market. However, the available evidence suggests that DOE regulations and changed consumer purchasing practices have contributed to the situation faced by independents.

THE ANTICOMPETITIVE EFFECTS OF S. 326

Having explained why, in our view, there is no need for enactment of S. 326, I would like now to discuss the severe anticompetitive consequences that are likely to result if this bill is enacted. Three provisions of the bill are of particular concern to us in this regard. First is section 2(a)(1), which prohibits major refiners from operating motor fuel service stations, the so-called "divorcement" provision. Second is section 2(b), which establishes a wholesale transfer price below which sales may not

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9/ Report at 193.

be made except where justified by cost or the need to meet competition. Third is section 2(d), which contains the bill's open supply provisions.

1. The Divorcement Provision

The Department is opposed to the divorcement provision of S. 326 because it will prohibit major refiners from utilizing an efficient means of distributing motor fuel preferred by many customers. By most standards, the retail gasoline industry is effectively competitive, and major oil companies have determined that partial vertical integration by refiners into retailing provides them with the most efficient and lowest cost means of distributing motor fuel. Prohibiting major oil companies from utilizing what they believe is the most efficient method of distributing motor fuel will not result in lower retail prices; rather, it is far more likely to force consumers to pay for a less efficient distribution method in the form of higher gasoline prices or lesser availability of supply, or both. 10/

Recognition that vertical integration may have benefits does not mean that the entire retail industry should be vertically integrated, for it is clear that independent dealers also serve an important function in this market. While many independent dealers

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10/ While section 2(a)(1) of the bill prohibits major refiners from "operating" retail service stations, the Department understands that this section is not intended to prohibit them from continuing to own and lease retail stations.

have gone out of business in the past few years, many others have continued to maintain profitable businesses. The competitive market should be permitted to determine the optimum mix of independent and company-owned outlets, as this will ultimately result in the best situation for consumers.

2. The Daily Uniform Sale/Transfer Price

The Department also opposes the pricing provisions of S. 326. Section 2(b) would require establishment of a daily wholesale transfer price for motor fuel and, with certain limited exceptions, would require a gasoline wholesaler to sell or transfer fuel only at that price, including sales to independent wholesale purchasers or to any person "related to the supplier." It has been contended by some that integrated refiners and branded and unbranded jobbers sell gasoline to independent dealers at one price and internally transfer gasoline to their integrated retail operations at a lower, non-competitive price. Section 2(b) attempts to prohibit such alleged predatory subsidization by mandating, with some exceptions, a single wholesale price for all sales or transfers.

There are several problems with this approach. First, as noted earlier, there is no evidence that predatory subsidization is occurring. Second, it is not likely to occur because it would not be of any benefit to the refiners. Moreover, it is not likely that such subsidization, if it existed, would succeed in driving independent dealers out of the market. Fourth, this provision appears intended to apply not only to price differentials between "arms-length" sales, but also to price differentials between an arms-length sale and an intracorporate transfer. 11/ Price discrimination involving two arms-length sales is already covered by section 2(a) of the Robinson-Patman Act, 12/ and we see no reason to enact additional legislation in this area.

However, the Robinson-Patman Act may not be applicable to a situation involving an intracorporate transfer, as such a transfer might not be deemed a "sale" for Robinson-Patman purposes. 13/ Thus, enactment of a provision applicable to such a situation would be a marked departure from existing law and would be without apparent justification. Generally, price differences reflect the normal operation of a market, and the prices charged or allocated to vertically integrated units generally reflect efficiency benefits in the form of reduced risks or transaction costs associated with that relationship. Thus, mandating a rigid, uniform daily wholesale

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11/ Although it appears that S. 326 was intended to reach intracorporate transfers such as those described above, it is not clear that the bill actually reaches such transfers. Section 2(b)(1) regulates sales between a supplier and a "person related to the supplier". A good argument can be made that a transfer between one firm's refining and marketing divisions is not a transfer between "related persons" at all because there is only one "person" involved. See definitions at sections 2(e)(7) and 2(e)(15).

12/ 15 U.S.C. § 13(a) (1976).

13/ See, e.g., Brown v. Hansen Publications, Inc., 556 F.2d 969 (9th Cir. 1977). See also Hearings Before House Comm. on the Judiciary on Bills to Amend the Clayton Act, 74th Cong., 1st Sess. 211, 229 (1935) (remarks of H. B. Teegarden).

transfer price may deny non-major refiners the ability to realize the efficiency benefits of their integrated structure and hence impose higher costs on consumers.

Moreover, we seriously doubt that provisions designed to regulate such intracorporate transfers would be effective. A comparison of the prices of an arms-length transaction and an intracorporate transfer between a firm's refining and marketing divisions would require an enforcement entity to monitor and verify the firm's internal transfer price and associated costs. In order to "go behind" the internal transfer price, it would be necessary to allocate costs between the marketing and refining divisions, a process which is inherently arbitrary. The bill does not provide any direction or mechanism for comparing these costs and prices. Furthermore, the same difficulties facing analysis of such transactions by an external monitor would be faced by a company in defending its pricing decisions. Thus, while the cost justification defense contained in section 2(b)(2)(A) is desirable, as a practical matter it is unlikely to be of much assistance to the company. Certainly that has been the history of the cost-justification provision in the Robinson-Patman Act.

In sum, the provision prohibiting an internal transfer and an arms-length sale at different "prices" would disrupt the pricing practices of integrated refiners and jobbers, and would considerably complicate these transactions. Moreover, the difficulty of pricing decisions would be influenced by the possibility of private damage actions as well as substantial government fines. Thus, to the extent that the bill's pricing provisions create further uncertainty with regard to pricing practices that may be lawful, it may well cause integrated refiners and jobbers to adopt extremely cautious and conservative pricing patterns in order to minimize their litigation risks. Such pricing rigidity would impede competition between refiners and, indeed, would further limit the ability of independent refiners to compete effectively with the major refiners. The result could be to further strengthen the market position of the majors and lead to higher gasoline prices at the retail level.

3. The Open Supply Provisions

The Department is also opposed to the open supply provisions contained in sections 2(c)(1)(A) and 2(c)(1)(B) of S. 326, which are intended to maximize a dealer's flexibility with respect to securing gasoline supplies. The first provision prohibits a supplier from interfering with a dealer's ability to secure gasoline from a different supplier. The second provision exempts exclusive dealing and/or requirements contracts from this open supply requirement if the contracts expressly allow a dealer to purchase gasoline from another source whenever the regular supplier's terms and conditions are not reasonably comparable to those offered by other suppliers.

The antitrust laws already prohibit unreasonable restrictions on a company's ability to purchase necessary supplies or otherwise operate its business. The legality of exclusive dealing and requirements contracts is principally governed by section 3 of the Clayton Act, 14/ which prohibits the sale of a product on the condition that the customer not deal with the supplier's competitors, where a substantial lessening of competition is likely to occur.

To the extent the bill's open supply provisions would go beyond existing law in this regard, we believe they would have undesirable consequences. While these provisions recognize the use of exclusive dealing and/or requirements contracts in this industry, they may severely and unnecessarily restrict their utility. Exclusive dealing and requirements contracts often provide benefits for both dealers and suppliers and, hence, most importantly, for consumers. Specifically, a buyer is benefited because such agreements assure a steady supply, can afford some protection against price increases, provide cost information necessary to make long-run plans, and obviate the expense and risk of product storage.

Exclusive dealing contracts may also reduce transaction costs between buyer and seller, allowing the benefits of the increased efficiency from this source to be passed on to the consumer in the form of lower prices. However, section 2(c)(1)(B) would permit the use of requirements and exclusive dealing contracts only when such contracts expressly permit the buyer the right to purchase

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14/ 15 U.S.C. § 14 (1976).

elsewhere whenever it is favorable to him to do so, and would therefore severely limit the usefulness of such contracts. Thus, this restriction may have the undesirable effect of denying firms the use of valuable business arrangements.

CONCLUSION

I believe a persuasive case has not been made for enactment of S. 326; indeed, the Report and our own knowledge of the petroleum industry strongly suggest that such legislation would be counterproductive. The bill would disrupt the functioning of the retail gasoline market and would dramatically interfere with competitive market mechanisms. In our view, the bill would have serious anticompetitive effects and, if enacted, would probably result in increased gasoline prices to consumers. Accordingly, the Department of Justice strongly recommends against enactment of this legislation.

Mr. Chairman, that concludes my prepared remarks. I would be happy to respond to any questions you or other members of the Committee may have.

Senator **Metzenbaum** acting chairman. Our next witnesses are Mr. Leonard Coburn and Mr. Arthur Price.

Mr. Coburn is acting director of the office of competition and Arthur Price is administrator of motor fuel inspection and gasoline tax division for the State of Maryland's Office of the Comptroller.

We are happy to have both of you with us.

As you see the list of witnesses to appear before the committee today is extremely long. Would you be good enough to summarize your statements? Your complete statements will be included in the record at the completion of your oral presentations.

STATEMENT OF LEONARD L. COBURN, ACTING DIRECTOR, OFFICE OF COMPETITION, OFFICE OF CONGRESSIONAL, INTERGOVERNMENTAL, AND PUBLIC AFFAIRS, DEPARTMENT OF ENERGY

Mr. **Coburn**. Thank you very much, Senator Metzenbaum.

I am Leonard Coburn, acting director, office of competition, and I appreciate the opportunity to appear before you today to present the views of the Department of Energy on S. 326.

Senator **Metzenbaum**. Mr. Coburn, I will be right back. I must make a phone call, but the staff director will remain.

I will be right back.

Mr. **Coburn**. As indicated, I will summarize my statement this morning. I would like to submit my entire statement for the record.

The Department of Energy opposes this bill, and I would like to discuss three points with you this morning to indicate why the Department opposes this legislation. There are other points as well, and they are covered in my written statement.

First: The marketplace since decontrol in January of this year is in a transition period. I would like to discuss that.

Second: I would like to cover the divorcement provision.

Third: I would like to cover the open supply provision.

First, I would like to address the marketplace since decontrol in January.

The marketplace is in a transition period from almost a decade of controls to a new consumer awareness, to new consumer tastes, and new consumer demands.

During this turbulent period, the transition from marketing expansion to marketing contraction because of shrinking demand and gasoline marketing withdrawals by various companies across the country, has created a different marketing situation from the one that we have experienced for many, many years.

The question is: Is this competitive process suffering during the turbulent period of transition or are only some of the competitors within that process suffering?

DOE's view is that the competitive process is healthy, while some competitors within the process may be experiencing hardships.

We view the present market transition as quite normal in a properly functioning competitive marketplace. Firms enter a market to seek new opportunities. Firms exist if operations are no longer profitable or demand is shrinking. That is a proper functioning of a competitive marketplace.

I guess the question that the proponents raise who sponsor S. 326 is whether this competitive process is taking place in an anticompetitive manner.

DOE's view is that it is not taking place in an anticompetitive manner. It is clear to us that a change in marketing strategy is taking place—one that is emphasizing low-cost marketing in a world of high-priced crude oil, high marketing expenses, and declining demand.

This marketing transition no doubt is creating hardships but we see no evidence that the overall competitive process has suffered any anticompetitive tendencies.

Government intervention during this transition period as proposed in S. 326 is not warranted.

I would like to address two specific parts of the bill—first, the divorcement provision and, second, the open supply provision. The other portions of the bill are covered in my written statement.

The Department of Energy opposes industry divorcement as a drastic remedy and not one that will help dealers. The facts do not support the alleged justification for divorcement. That justification is based on the proposition that refiner/suppliers who market through their own retail stations are subsidizing these operations with the predatory intent of driving their lessee dealers out of business.

We strongly disagree with this proposition.

DOE has conducted a rather extensive study over a several-year period. That study has found no general evidence of subsidization and no general evidence of predation.

Let me indicate three reasons why we have come to that conclusion. There are others as well which are covered in the written statement and in the study. I will not cover them now, but there are three major reasons:

First, the prices charged by company-operated stations are not generally subsidized. This was done in an empiric manner, and we have found no subsidization.

Second, market share shifts do not show that company-operated marketers have reaped the fruits of a predatory campaign. If there is a predatory campaign underway, one would expect to see an increase in market position by those companies operating through company operations. That has not occurred.

Third, refiner/suppliers operating their own stations are not the major beneficiaries of the shift away from distribution through dealers. Surprisingly enough, the major beneficiaries are other small businesses. Branded jobbers and independent marketers have captured larger shares of the marketplace.

The CHAIRMAN. Excuse me just a minute. This will be off the record.

[Off the record discussion.]

Mr. COBURN. These three factors I have just outlined, plus the others indicated in my written statement, refute any contention that refiners are trying to control the marketplace in an anticompetitive manner.

Ask yourself the question: Why is a predator losing market share to independent marketers and jobbers if it is also reaping the benefits of a predatory campaign?

Clearly the answer is contradictory. In our view, we would like to put the allegation of predatory subsidization to rest once and for all.

I would like to briefly address the open supply provision, and then I will conclude.

The proponents of this legislation urge that open supply will increase dealer flexibility. It also may lead to the dealer's demise.

The reason is simple. Why would a supplier finance a dealer which is a costly undertaking in today's marketplace with no assurance that the dealer will buy from the supplier? It is likely that the supplier will require higher rents to reflect present-day high real estate values and require various fees for the use of a brand. This will drive lessee dealer costs up and probably drive the lessee dealer out of business.

For these reasons and the others elaborated upon in my written statement, the Department of Energy opposes the legislation.

This concludes my oral presentation. I would be glad to answer any questions you may have.

Thank you.

The CHAIRMAN. Mr. Price, if you will give your statement, we will then have a few questions for both of you.

STATEMENT OF ARTHUR E. PRICE, ADMINISTRATOR OF MOTOR FUEL INSPECTION, STATE OF MARYLAND

Mr. PRICE. Thank you, Mr. Chairman.

I will try to briefly summarize my statement.

The CHAIRMAN. You want your entire statement to go in the record?

Mr. PRICE. Yes.

The CHAIRMAN. Without objection, that will be done at the completion of your oral presentation. You may just highlight your statement.

Mr. PRICE. Thank you.

With our statement being offered for the record, we will touch quickly on just the highlights.

The comptroller of the State of Maryland Louis L. Goldstein feels very strongly in favor of this bill and of service station divorcement. He would be here personally himself today to emphasize that except for the fact that the State of Maryland is having the largest general revenue bond sale in its history, and he felt that took precedence.

Complaints of lease cancellations and other discrepancies in the quotas of gasoline allocated to different kinds of retail service stations flowed into our office and the office of other officials and the Governor during the spring and summer of 1973.

A study was conducted at the direction of the Governor to determine what was the situation of gasoline marketing in our State.

From that study, divorcement legislation was ultimately passed in the Maryland General Assembly and signed into law in 1974. The results of that survey will be provided to the committee.

The law, of course, was challenged through all the courts up to and including the U.S. Supreme Court. It was ultimately upheld in a mandate issued on July 13, 1978.

Because of the original intent of the Maryland divorcement law, there was a 1-year grace period provided in order for the producer-refiner company-operated outlets to be leased to dealers, effecting the fact that divorcement has only been implemented since July 13, 1979, and not totally due to ensuing court challenges.

The effects of Maryland's divorcement law, we believe, have been beneficial to the consumer and to the retail service station dealer. Arguments have been advanced that divorcement causes increased prices.

This spring our office conducted a study of prices and apparent dealer margins as reported by the Platt's Oilgram and the Lundberg Letter. That information was supplied to Chairman Bedell's committee with respect to his bill, and we will offer that same information to this committee.

Senator METZENBAUM. Mr. Chairman, I suggest that be made a part of the record.

The CHAIRMAN. Without objection, it will be so admitted.

[Material to be supplied follows:]

STUDY CONDUCTED BY OFFICE OF COMPTOLLER OF THE TREASURY, STATE OF MARYLAND

1. The allegations that dealer margins increased dramatically in Maryland following divorcement are invalid for several reasons. First, the divorcement law was not

put into effect until July 13, 1979, one year after the U.S. Supreme Court's mandate was received. This was consistent with the original Maryland statute, which provided a one year grace period for leasing stations to dealers. Even after the law went into effect, extensions for 74 outlets were provided into October and November 1979. Approximately 28 Citgo outlets will be company operated until November 1, 1981, because of recently concluded litigation. Therefore, dealer margins at the time of the Supreme Court's decision are not related to divorcement.

Secondly, comparisons of dealers margins in Maryland and Virginia during the early spring and summer of 1979 are questionable because of varying market conditions. Lines at retail stations were common in Maryland at that time and have been attributed to inequitable allocations under federal controls. We believe any comparisons between markets during the period of federal price and allocation controls are dubious since these other factors had such strong influence on the marketplace.

The lifting of federal controls in January, 1981 meant that divorcement became the most prominent difference in the marketplace. Based on the fact, the nationally recognized Lundberg Survey indicates the following:

APPARENT DEALER MARGIN REGULAR UNLEADED GASOLINE—SELF-SERVE

	January 1980	January 1981	August 1981,	Reduction in margin January 1980 to August 1981
Baltimore	$0.1361	$0.0638	$0.0415	$0.0946
Norfolk	.0987	.0603	.0625	.0362
Atlanta	.1059	.0855	.0753	.0306
Philadelphia	.1349	.0872	.0570	.0779

The benefits to the consumer at a time when divorcement is the primary difference in the marketplace are clear.

2. Apparent margin regular unleaded self-service gasoline, month of August: (Report by the independent Lundberg survey)

	Norfolk	Baltimore
1980	$0.0897	$0.0949
1981 (gallon)	.0625	.0415
Change	2.72	5.34

We believe this attributable to Divorcement; there is no other factor common to both markets, to the best of our knowledge.

3. Yes, we believe prices in Maryland are lower than they would have been without the Divorcement statute. Following statistics are offered from Lundberg survey for August 1981. See chart titled "Posted Prices and Dealer Margins" attached.

4. It is true, in my opinion, that extremely intense competition exists in Norfolk, Virginia due to the great number of PX Exchanges selling gasoline. Facilities such as Naval Operations Base, Amphibious Base, Submarine Base, Oceana Naval Air Station, Portsmouth Naval Shipyard, and perhaps others, exist in Norfolk, while no such comparative condition exists in the Baltimore area. The Lundberg survey for August 1981 further points to the increased competitive activity that we believe to be spawned primarily by divorcement—which placed more independent small business people in the marketplace. This August survey reflects lower posted prices for the consumer and even lower dealer margins as follows:

Regular leaded s/s	Retail average price	Fuel tax differential	Retail price (tax adjusted)	Dealer margin
Norfolk	$1.2656	+$0.02	$1.2456	$0.0430
Baltimore	1.2372		1.2372	.0255
Difference			.0084	

The September 1981 Lundberg survey continues to reflect even lower margins; Norfolk 3.47¢ versus Baltimore 2.18¢

5. Divorcement builds stability in the marketplace by reducing the conditions and frequency of dealer changes normally at the discretion of the Major Oil Company (Lessor). A producer/refiner can only operate under three (3) specific conditions set forth by regulation; 1. the dealer dies, 2. vacates station in breach of lease, or 3. is evicted for cause. Therefore the oil companies have less reason to arbitrarily cancel leases to operate stations directly, at higher profit.

6. We do believe Divorcement increases competition and the aforementioned figures support that belief in the form of lower posted retail prices and lower dealer margins, both of which benefit the consumer. The approximately 300 stations operated by 12 major oil companies are now being operated in essence by 300 individual small business persons thereby placing more "actors" in the marketplace and greatly increasing competition.

7. No; no major has stopped servicing Maryland. Ashland Oil Company and Continental Company operating a total of 24 secondary brand stations, discontinued retail operations in the State. However Amoco Oil Company took over the operation of 14 of these, others found their way into the hands of individuals; consequently, consumers benefited through the rehabilitation by Amoco and enjoyed an additional grade of gasoline to select from along with credit card and other amenities not afforded by the prior operation.

8. No consumer has responded to divorcement. Being a Tax and Regulatory Agency, to us, "no news is good news". There was concern by a few during the final days of litigation but only with respect to the possible loss of allocation; at that time we were under Federal controls and received assurances from Energy Department that the volume would stay within the state should any supplier decide to withdraw from the State.

POSTED PRICES AND DEALER MARGINS

	Retail average prices [1]	Motor fuel tax differential [2]	Retail price (tax adjusted)	Dealer margin [1] (cents)
Regular leaded:				
Atlanta	$1.2533	−$0.015	$1.2683	3.68
Norfolk	1.2656	.02	1.2456	4.30
Baltimore	1.2372		1.2372	2.55
Washington, D.C	1.2766	.04	1.2366	4.36
Philadelphia	1.3238	.02	1.3038	5.74
Regular unleaded:				
Atlanta	1.3350	−.015	1.350	7.53
Norfolk	1.3248	.02	1.3048	6.25
Baltimore	1.2926		1.2926	4.15
Washington, D.C	1.3364	.04	1.2964	6.39
Philadelphia	1.3603	.02	1.3403	5.70

[1] Platts/Lundberg Report, August 1981 (self-service).

[2] Commerce Clearing House, Inc. (July 1981).

NUMBERS OF RETAIL SERVICE STATIONS

	Maryland [1]	Region [1]	United States [1]
January 1979	3,480	57,200	170,600
March 1981	3,286	46,800	136,700

NUMBERS OF RETAIL SERVICE STATIONS—Continued

	Maryland [1]	Region [1]	United States [1]
Net loss	[2] 194	[3] 10,400	[4] 33,900

[1] Lundberg Letter, Mar. 20, 1981.
[2] 5.6 percent.
[3] 18 percent.
[4] 20 percent.

Mr. PRICE. In closing, let me say that we believe Maryland has lower prices and a more stable marketplace because of our divorcement law.

The resulting competition among small businesses have also benefited the consumer through improved services at the retail service station.

We will offer to the committee a chart reflecting dealer margin in 1980, versus August of this year, in an effort to illustrate the effect of divorcement upon said dealer margin for that period of time that divorcement has been implemented.

That hurriedly covers my presentation, Mr. Chairman. I will be delighted to try to answer any questions.

The CHAIRMAN. Thank you very much.

Mr. Coburn, I have a few questions for you and then a few for Mr. Price.

I believe you state that open supply will create less incentive for refiners to sell to dealers. However, couldn't the refiner raise rents and other service charges to compensate for what revenues he might lose due to open supply?

Mr. PRICE. I am not quite sure, Senator, I can comment on that. There are many roads that one can take to maximize his profits.

The CHAIRMAN. That was a question for Mr. Coburn.

Mr. PRICE. I beg your pardon.

Mr. COBURN. The answer is that open supply, basically, breaks the partnership or contractual arrangement that now exists, or would exist between a refiner and a dealer.

The supplier has to recover the costs of putting a dealer into a particular location. If he cannot recover those costs through supply, he is going to have to recover some other way.

As a result, the way to recover those costs is through rents, branding charges, and so forth.

The dealer is going to somehow pass those charges on either to its customers or its margins are going to dwindle to zero or negative. If that happens, I do not see how the dealer benefits.

The CHAIRMAN. Mr. Coburn, can you offer any explanation as to why the change from branded dealers to company operations is occurring primarily in the upper Midwest?

Mr. COBURN. I think there are some unique situations in that particular area of the country. For instance, Standard Oil of Ohio has traditionally pursued a company operation since the late 1930's. What we are seeing now is just a continuation of what it started many years ago that was temporarily halted by the price and allocation controls. It also was temporarily halted by a consent decree situation because of the acquisition by BP of Sohio.

There has been a very long tradition in that particular part of the country, at least from Standard Oil of Ohio.

Marathon has changed its particular marketing operation. Again, because of one or two other major companies and independent companies, that area has experienced a larger shift than others.

I do not think there is any particular reason why those refiners are doing it in that part of the country versus other areas. It is a question of whether those companies find direct operations to be more profitable than the traditional dealer arrangements.

The CHAIRMAN. Mr. Coburn, did the DOE study find any evidence of refiners selling at retail prices below their wholesale prices to dealers? If so, is there any innocent explanation for this behavior?

Mr. COBURN. I think the explanation is one of trying to attempt to maximize profits. There are drastically different cost structures in operating a wholly owned station versus operating through a lessee dealership. Just because prices vary does not necessarily mean that those costs are not being recovered.

I do not think we found evidence in our study that costs were not being recovered through different channels of distribution. As long as costs are being recovered, there is no subsidization. As a result, prices can vary substantially in a marketplace because one avenue of distribution is much more efficient and less costly.

The CHAIRMAN. You mentioned the Connecticut experience with divorcement in your written statement. Have any studies been done of the effect on prices in Connecticut? Has Connecticut passed a law to divorce jobbers? Do you know of any other States that have passed such a law?

Mr. COBURN. We have not looked at prices in Connecticut. We are aware that they have passed a refiner divorcement bill. A jobber divorcement bill has been introduced in the State of Connecticut but has not passed, as far as I am aware at the moment.

In other States, I could provide you with a list of those States that have attempted to pass divorcement, although as far as I am aware none have succeeded.

The CHAIRMAN. Mr. Coburn, do you agree with the results of the Maryland study referred to by Mr. Price that consumer prices were lower after divorcement?

Mr. COBURN. I would be hard pressed to call the very brief survey that Maryland did a study.

We have looked at the same figures that Mr. Price has looked at.

On their face, they show that Maryland's prices are about the middle of prices along the east coast seaboard. It does not indicate anything with respect to divorcement as far as I am concerned until a more thorough analysis is done, trying to isolate the exact effects of divorcement.

In addition, it is interesting to note that Mr. Price did not say that there are still some refiner operated stations that have achieved waivers from the divorcement provision, so it is hard to really isolate exactly what has happened in the State of Maryland since their experience is very recent and is not complete.

The CHAIRMAN. Mr. Price, you stated your office conducted a study on prices and dealer margins in Maryland last spring and that the prices in Baltimore were lower than in other east coast cities; is that correct?

Mr. PRICE. That is correct.

The CHAIRMAN. In his written statement, Mr. Coburn stated that Maryland's data failed to consider transportation charges and State taxes. Would you comment on that?

Mr. PRICE. One of the documents, as a part of our testimony, illustrates a comparison between five cities neighboring Baltimore—namely Atlanta, Norfolk, Baltimore, Washington, and Philadelphia—in which we have illustrated the retail average price as determined from the Platt's/Lundberg report for August 1981. We have adjusted that with a motor fuel tax differential where it exists so as to reflect a retail price tax adjusted.

If you will refer to that chart, Mr. Chairman, I think you will see that Baltimore is outstandingly lower in its retail price, tax adjusted, than those cities that we have mentioned.[1]

It is also significant to point out that the dealer margin, for example, on regular leaded gasoline, as reflected by the same Platt's/Lundberg August 1981, reflects a dealer margin in Baltimore of 2.55. Its next nearest competitor, per se, is Atlanta with a 3.68 dealer margin.

Mr. COBURN. Mr. Chairman, if I may comment, the study that we were referring to was the one that was submitted before the House Committee which had a different set of figures. It was not updated until August 1981 because the hearing took place before August 1981.

We were commenting on the prior study. If a new study has been corrected and adjusted, then we would be glad to take a look at it. We have not had the opportunity to do that.

The CHAIRMAN. We would be glad to have you do that and then make any comments to us right away.

Mr. COBURN. I would be glad to do that.

[The following comments of DOE on Maryland study of gasoline prices after divorcement were subsequently supplied for the record:]

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[1] Charts may be found on pages 448.

Department of Energy
Washington, D.C. 20585

November 16, 1981

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

This is in response to your request for an analysis of the Maryland data concerning the effects of divorcement subsequent to the hearing on S. 326, the Small Business Motor Fuel Marketer Preservation Act of 1981.

In the Department's view, the analysis of the effects of divorcement in Maryland is seriously deficient in several respects. The analysis cannot be confined only to the Platt's/Lundberg price survey to determine the effects of divorcement in today's dynamic gasoline markets. Other data must be gathered and used, namely, all the primary factors that affect gasoline marketing must be included in the analysis to assure a realistic possibility of valid conclusions being derived from the analysis. For example, when comparing price changes in Norfolk and Baltimore, it is stated in Maryland's response to question 2 that no factors were common to both markets. If no factors are common, then it is impossible to determine the effects of divorcement from an intercity comparison of price changes. The following are more specific comments on the methodology adopted in the analysis by Maryland.

1. Comparison of data from the era of EPAA price and allocation controls with data in a decontrolled environment cannot yield valid conclusions. While apparently acknowledging this point, Maryland then ignores its own analysis. For example, Maryland's answer to question 1 compares data from January 1980 and 1981 with data from August 1981 for four cities. Since controls were in effect throughout January 1980 and 27 days of January 1981, the comparison has no implications regarding the effect of divorcement.

2. The data provided do not indicate the price paid by the average consumer. This is because the Platt's/Lundberg price survey data are weighted by the number of outlets rather than by gallonage. For example, if there were 10 outlets in the survey, the retail price of each outlet receives a weight of 10 percent. Then, if one station surveyed had a price, and apparent margin, 20 cents above every other station, it would still receive the 10 percent weighting factor although its volume of gasoline sold undoubtedly would be less than 10 percent of the total sold by the 10 outlets. Thus, the average paid by the consumer would be overstated in this hypothetical case.

3. There is no analysis or other indication concerning why the particular cities chosen by Maryland are suitable for a determination of the effects of divorcement. Some reason other than being on the East coast must be developed. Using the cities chosen by Maryland does

not provide any conclusive way to know whether apples and oranges are being compared. For example, the analysis does not provide the number or volume of company operations in the comparison cities. If the analysis simply compares lessee dealers with lessee dealers, there can be no implications as to the effects of divorcement. A further aspect of the market should also be considered, namely, the number and volumes of independent marketers such as jobbers and chain retailers. These typically are very price competitive marketers so that any systematic differences between market areas concerning this market segment must be taken into account. Finally, since Citgo still runs company stores in Maryland, the comparison could be biased by their presence in Baltimore.

4. There is disagreement between other witnesses and the State concerning the total tax level in Atlanta. Depending upon the resolution of these differences, the Atlanta comparisons still may be distorted by not correctly accounting for tax differences.

5. There is no transportation cost differential included in the analysis. If these costs differ significantly among the comparison cities, the validity of the comparisons would be questionable. For example, some cities are supplied primarily by pipeline, others by tanker, and some by a combination of the two. These variances could affect the price of product.

6. Changes in the local economy must also be included in the analysis. For example, gasoline consumption tends to decline when real disposable income declines. Changes in the local price level could cause apparent nominal price increases to mask a fall in the real price of gasoline (and other goods and services). Changes in the price and availability of alternative transportation modes would make the demand for gasoline more or less elastic in various locales. Indeed, various locales in all likelihood would have demand functions for gasoline with characteristics sufficiently different to obviate the validity of any simple price comparisons. For example, if the demand for gasoline in a comparison city is less elastic than in Baltimore, the quantity demanded of gasoline would decline less in response to a price increase. This implies that consumers bear a greater proportion of the price increase in the comparison city than in Baltimore. This hypothetical situation could explain, in part, differences in the way apparent margins change from city to city.

7. Great care should be taken to avoid endpoint problems. The choice of beginning and ending time periods could reverse the findings. For example, if the seasonal driving patterns differ between two cities being compared, then one would expect price variations to appear due to the normal cyclical price variation rather than because of any underlying changes in the market. Data presented in the May 15, 1981, Lundberg Letter indicate that Virginia and Maryland do tend to have different seasonal driving patterns.

8. The State expresses the belief, in answering question 6, that 300 additional actors have been added to the marketplace and thereby greatly increased competition. The State's testimony, however, indicated there were 250 company-operated outlets in July 1978, not 300 as implied in the answer to question 6. Furthermore, if competition has increased, by definition consumers are better off. If consumers are better off, it must be because the operation of these outlets has somehow "improved" and had an invigorating impact on competition. Maryland, however, does not provide any analysis of the current condition of these 250 (or 300) outlets that would lead to the conclusion that consumers are better off. There is an allusion

to Amoco's operation of 14 former Ashland stations and availability of their credit card as an example. Interestingly, in analyzing the results of Maryland's 1973 survey of gasoline outlets, the State concluded that the lessee dealers of the major oil companies "appeared to seize upn [sic] the opportunity to reduce station hours by eliminating Sundays, closing early, etc., while still selling basically the same volume of gasoline as in the previous months of the prior years." At the same time, the 1973 survey analysis strongly implies that company stores such as Ashland's tended to remain open. It is not clear, then, if past is prologue that the consumer is better off by the change required by divorcement. The analysis must examine the ultimate disposition of these 250 (or 300) outlets, their prices, their volumes and modes of operation, their sources of supplies, changes in the availability of credit cards, and changes in the hours of operation before concluding that consumers are better off because of divorcement.

9. The apparent margin, even if it is a reasonable approximation to the actual per-gallon margin, does not reflect total profitability of an outlet. An outlet with a very high margin usually sells a very small quantity of gasoline, while an outlet with a small margin usually sells a relatively large volume. It is quite likely that in these circumstances the outlet with a smaller margin is more profitable than one with a very high margin. Thus, in order to evaluate properly the levels of, and changes in, margins across cities or in a city one must determine whether volume per outlet has changed. Simply looking at apparent margins and changes in them has no direct implications as to profitability.

10. A dealer's margin may fall because of lowering its retail price or because its buying price increases. For example, according to the Platt's/Lundberg survey, the dealer buying price in Baltimore increased by 6.84 cents per gallon from January to September 1981, while retail prices increased by 4.53 cents per gallon. (All prices refer to regular leaded, self serve.) Thus, the entire change in the apparent margin, a decline of 2.31 cents per gallon, was paid to the dealer's suppliers.

11. Maryland states that consumers are better off because the average apparent margin is lower. As should be clear from the preceding discussion, this conclusion is not valid. Only if margins fall as a result of increased gallonage would consumers be better off. This does not appear to be the case. If so, both consumers and dealers are worse off with divorcement.

This critique provides the key reasons why the analysis supplied by Maryland cannot be relied upon to demonstrate the supposed success of divorcement. The best that can be said at the moment is that the evidence is inconclusive. A more rigorous study taking into account the factors mentioned above must be conducted before any valid conclusions can be drawn on the effects of divorcement.

If the Department can be of any further assistance during the course of the Committee's deliberations, we would be glad to be of assistance.

Sincerely yours,

Leonard L. Coburn

Leonard L. Coburn
Acting Director
Office of Competition

The CHAIRMAN. Mr. Price, do you feel that the price of gasoline in Baltimore was cheaper, even if you consider transportation charges and State tax?

Mr. PRICE. Cheaper than the State of Texas?

I am sorry, Senator, I did not hear the last part of the statement.

The CHAIRMAN. I just stated to you a while ago that in his written statement Mr. Coburn made the statement that Maryland's data failed to consider transportation charges and State taxes. You made some comment in response to that.

Now I am asking you: Do you mean that the price of gasoline in Baltimore is still lower than other places if you take into consideration transportation charges and State taxes?

Mr. PRICE. Of those places that we itemized and compared on our chart, yes, sir. That cost of transportation, or whatever, is ultimately in those goods when it is posted at the retail pump.

Our study is predicated on the retail pump posted price.

The CHAIRMAN. What did the study conclude about dealer profit margins?

Mr. PRICE. That there was a far lower dealer profit margin in Baltimore than in those cities that we compared.

It further illustrated when we compared the dealer profit margin for January 1980 versus August 1981, the latest data available to us, that there had been a change in dealer margin to the extent of almost 11 cents in Baltimore. It was an 11 cent reduction.

The Lundberg letter of January 1980 reflects a dealer margin in Baltimore of 13.34 cents per gallon. The August was 2.55, for a net change of 10.79.

We believe it reflects the additional actors and competitors in the marketplace because the bulk of the company-operated service stations are now dealer-operated.

The CHAIRMAN. Thank you very much.

Senator Metzenbaum?

Senator METZENBAUM. Mr. Coburn, in your figures when you made these studies, did you look at the question of fixed costs and capital costs as well? Did you include that?

Mr. COBURN. Yes. We made an attempt to look at fixed costs on an allocated basis as best we could. Capital costs were not included in the analysis that we used.

Senator METZENBAUM. How can you not include capital costs? Isn't that comparing apples and oranges?

Mr. COBURN. No.

Senator METZENBAUM. Aren't capital costs a very major factor for both the dealer, as well as for the company-owned station?

Mr. COBURN. I think if you isolate out and take away the same factor from both sides of the equation, then the equation remains in equilibrium.

As long as capital costs are not being included on either side, there is no problem. I would suspect that the capital costs for a dealer, if we had to include them, would be higher than the capital costs for a refiner because of different access to capital.

As a result, the equation is probably biased in favor of the dealers.

Senator METZENBAUM. Why do you make that assumption? What is the basis for that?

Mr. COBURN. My basis is just a somewhat scant knowledge, but I do read the financial papers. Usually a major company has access to capital at prime rate, whereas a small company may have access at something above prime rate.

Senator METZENBAUM. The dealer may very well have owned a station for a good many years. The company may have had to come in and buy a very expensive corner and build a very expensive station. It does have some relevance doesn't it?

The dealer may have had the station for 30 years. The company may have just gone out and bought that very expensive corner.

Don't you think you should take that into consideration?

Mr. COBURN. I think the reverse could be true as well.

I think the study was an attempt to look at prices and costs between dealers and refiners, trying to isolate as much as we could. I do not think the capital costs could have been broken down as easily as one suspects they could have.

As a result, we used an analysis that focused in on variable costs which is really the most important part of the equation. We tried to allocate other types of costs as well where we could.

I think the results will stand for themselves. I think by trying to take them apart and say why didn't we do this or that, it is fairly easy to try to undermine the data. They also indicate rather clearly, I think, and have gotten a great deal of support from the academic community as well, that the study has allocated costs properly and has shown the proper distribution of costs through various distribution networks.

Senator METZENBAUM. You say it has support from the academic community.

While you were putting the study together, did you discuss the problem with any of the dealer marketing operators or organizations?

Mr. COBURN. Yes; we did.

I think we could indicate to you and show you that we had gone out and talked to literally hundreds of people from the entire spectrum of the industry in an attempt to accumulate the facts. We were extremely responsive in public hearings. We held hearings around the country where dealers and refiners and the entire spectrum showed up and testified. We talked with them personally in followups.

I think we have ferreted out the facts as best we could from the entire spectrum of the industry.

Senator METZENBAUM. Did you hear from some of the dealers about some of the predatory tactics, such as exorbitant rent increases, changes in credit practices, and unreasonable requirements in the contracts? Did you hear that kind of evidence?

Mr. COBURN. We heard allegations of predatory conduct. Whether those were, in fact, predatory conduct is something that is rather difficult to determine, but we did look at them.

We looked at those allegations rather carefully. The investigators who conducted the study talked with those people and determined as best they could whether those allegations were "predatory" or whether they were profit-maximizing types of things that companies were doing.

Our conclusion was that they were not predatory.

Senator METZENBAUM. Did you find any instances in which company-owned stations were selling at a lesser price than they were selling to the dealers who were located nearby, such as Senator Specter referred to and I referred to?

Mr. COBURN. We heard evidence from dealers who alleged that their buying price was higher than the selling price across the street.

We have not been able to verify whether those prices reflect any sort of subsidization or predation.

Senator METZENBAUM. Isn't there a local doctrine that applies here? That if the company is selling it for less across the street than it is selling it to its dealer and has to pay all of its costs in addition, doesn't the thing speak for itself? Isn't it evident that there was subsidization?

Mr. COBURN. I do not think so, Senator. I think we are looking at two different types of costs.

There are a different variety of costs associated with a dealer operation than there are with a company operation. The company operation normally has had much lower costs.

If you compare the costs of operation, a company may be able to maximize its profit and sell at a lower cost and a lower price than it is selling through a different distribution.

Senator METZENBAUM. Explain that to me. I am stupid.

Explain to me how a company-operated station across the street from an independent marketer can sell for $1.20. No matter how well they operate, how is that a better business deal for them than selling to the dealer who is an independent marketer at $1.22? Tell me how. What kinds of economies or efficiencies can you put into effect in that kind of manner?

When you sit here and tell me that they can achieve these things, I used to be in business. I never figured out how I could totally wipe out my costs. I do not know how a company can wipe out their costs.

Tell me how you came to that conclusion that there were economies they could put into effect that the independent could not put into effect, because I just cannot understand that and I do not smoke pot.

Mr. COBURN. One example would be to have a manager who manages multiple locations.

Senator METZENBAUM. What multiple locations?

Mr. COBURN. Let us say you have a refiner operator who has more than one location.

Senator METZENBAUM. Five locations. Instead of paying the manager $30,000, you only allocate $6,000.

Mr. COBURN. That is right.

Senator METZENBAUM. That still brings down the $1.20 doesn't it?

Mr. COBURN. That is a substantially different charge. If he can allocate to that one station only $6,000 in costs versus $30,000, he can reduce his price of gasoline substantially.

If the other employees are earning minimum wage, versus across the street at the dealer where there is a manager and an owner and other types of operators—you have skilled technicians who are fixing automobiles perhaps—you have only one station to cover that particular cost.

Senator METZENBAUM. Mr. Coburn, don't confuse the issue.

Mr. COBURN. I am not.

Senator METZENBAUM. They are selling to the dealer for $1.22. They are selling it to the public at $1.20. You tell me exactly how that can occur.

No matter how many efficiencies the company has, how can they still do better than selling at $1.20.

Mr. COBURN. I think it sounds like an anomaly. I think that there are a great deal of efficiencies that an integrated company can incorporate into its final price where it cannot do the same through an independent.

Senator METZENBAUM. Name one efficiency that makes it possible to sell to the public at a company-owned station at a lower price than you are selling to the dealer.

When you sell to the dealer, you deliver the gasoline to him. You get $1.22. He pays you the money, and you take it home and put in the bank.

When you put it in your own station and you are selling it to the public at $1.20, no matter what minimum wage you pay your employees and no matter how little you pay the electric company and no matter what you figure are your capital costs and no matter what you pay your manager and no matter what you do, you have to come out with less than $1.20. Maybe you wind up with a net of $1.10 or $1.08 or $1.12.

Tell me what kind of business efficiencies you can figure out to make $1.20 become more income to the company than the $1.22 they are getting from the dealer.

Mr. COBURN. First of all, I indicated one with the employee situation.

Senator METZENBAUM. That isn't one. Let's drop that. That isn't one.

Doesn't that take off from the $1.20 net?

Mr. COBURN. I do not accept the fact that is not one.

If you have a different employee structure, you are bound to have different costs involved.

Senator METZENBAUM. I am not talking about the costs. I am talking about the $1.22 paid by the dealer.

He pays the company $1.22 for his gasoline. Now the company gets $1.20 at retail. Tell me no matter how low the costs are of the company-owned station, how does the company wind up with more money?

Mr. COBURN. It winds up with more money by selling more.

Senator METZENBAUM. I had heard that theory when I was in business that you do better if you lose. You are not doing well but you are losing more on each sale than your competitor and that makes you make more profit. Your volume is greater; is that it?

Mr. COBURN. If you are selling 150,000 gallons through the one station, you can earn more than if you are selling 30,000 gallons through the station across the street.

Senator METZENBAUM. Let's see.

Mr. COBURN. I am just taking figures out of the air. The idea is that there is an efficiency in terms of the cost for gasoline and the price for gasoline.

You are mixing things here that are difficult. First of all, you do not know what the transfer price is.

Senator METZENBAUM. I told you what the transfer price is. I said $1.22 and the public is paying $1.20.

Mr. COBURN. You only told me one transfer price. You didn't tell me what the oil company's transfer price is.

Senator METZENBAUM. What do you mean by that? Explain that to me. I am not very smart.

Mr. COBURN. All right.

The oil company transfers its price or has an internal transfer price.

Senator METZENBAUM. A bookkeeping transaction.

Mr. COBURN. Exactly.

Senator METZENBAUM. And it shows that it is only getting $1.08 for that gasoline that it is selling to its own station; but it is getting $1.22 from the dealer. Is that what you are saying?

Mr. COBURN. I do not know what the numbers are.

Senator METZENBAUM. Whatever the numbers are.

Mr. COBURN. There is an internal transfer price.

Senator METZENBAUM. I am the president of the company and the board of directors asks me: How are you making more money by selling it at $1.08, or whatever the number is, when you can be selling it to those dealers for $1.22. Tell me how we are doing better that way; we do not quite follow that.

Mr. COBURN. He then demonstrates through a volume comparison the total profit and whatever the costs are for that particular location versus the costs for the other location. If the bottom lines comes out that he is maximizing his profits one way—

We are dealing with abstract numbers. We are dealing in theories.

Senator METZENBAUM. Mr. Coburn, I would like to urge you never to go out in the private business world. Just stay in Government. You will do the best there.

Don't go into the private business world because it is a little more complicated than that.

Mr. COBURN. I agree it is complicated, and I think we are trying both to be a little bit simplistic about it.

Senator METZENBAUM. I am not being simplistic at all.

I guess it is simplistic, $1.22 against $1.20 is very simplistic to me.

Then you have to take that off your costs.

No matter how many internal transfer figures you use, you wind up with a lower net for the company in that manner.

The only reason you do it—and I do not understand why the Department of Energy could not find it out—is to squeeze out the independent dealer so that you can wind up owning all of the marketing facilities.

Mr. COBURN. If I may respond, I think it is interesting, if that is the goal, that independent marketers in the marketplace sell more gallons than they did before and branded jobbers in the marketplace sell more gallons than they did before.

If that is true, how does the refiner/supplier make out better by having more rigorous competitors as independent marketers have traditionally been the most price-sensitive marketer in the country and have always set the price in the marketplace?

How does that happen?

Senator METZENBAUM. How does what happen? I am not following you.

Mr. COBURN. How does the refiner/supplier come out better if, in the process of squeezing out, as you say, independent or lessee dealers, there are now more vigorous competitors in the marketplace who have a greater market share?

Senator METZENBAUM. There are less vigorous competitors in the marketplace.

Mr. COBURN. That is not true. That is not what our study shows.

Senator METZENBAUM. The company owns all the stations.

Mr. COBURN. That is not what our study shows. Our study shows that, over a period of years, there has been an increase in independent marketer gallonage and an increase in branded jobber gallonage.

Senator METZENBAUM. You are telling me that there are more independent marketers now than there were 5 years ago?

Mr. COBURN. That is correct; that is what our studies show.

Senator METZENBAUM. That is not what every independent source in the whole Nation has said.

Mr. COBURN. That is not what our study shows.

Senator METZENBAUM. Every independent source.

Mr. Chairman, I will submit that for the record at this point.

The CHAIRMAN. You can submit that and you can submit your figures, Mr. Coburn.

I do not think there is any use to continue this, because you all do not agree.

Senator METZENBAUM. That is true.

The CHAIRMAN. Do you have any questions of Mr. Price, Senator Metzenbaum?

Senator METZENBAUM. I just have three.

Mr. Baxter questioned the factual reference I made that there are less dealers going out in Maryland today as compared to other States. Would you agree with that statement? Have you studied that subject?

Mr. PRICE. The numbers that we acquired were acquired from a nationally accepted firm of Lundberg who this past January reported a 20-percent loss in retail service station outlets nationally.

He went on to report an 18-percent loss in the region that Maryland is a part of.

In the State of Maryland, our figures reflect only a 5.6-percent loss.

Senator METZENBAUM. Thank you.

You have already testified that the prices have been lower in Maryland than they were in the past or that they were as compared to comparable States.

Mr. PRICE. The dealer margin is lower. Posted prices, I guess, depending on when you begin, Senator Metzenbaum, have been higher. When compared with those neighboring cities that we compared against, the margin itself indicated to us that it was being delivered to the consumer in the most efficient manner.

Senator METZENBAUM. I thank you, Mr. Chairman. I know you have other witnesses.

The CHAIRMAN. We thank you, gentlemen, for your testimony.

Senator METZENBAUM. May I submit questions for the record, Mr. Chairman?

The CHAIRMAN. Without objection that will be done.

[Material to be supplied follows:]

Department of Energy
Washington, D.C. 20585

November 13, 1981

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

This is in response to the question submitted by Senator Metzenbaum following the hearing on S. 326 before your Committee on October 21, 1981. Senator Metzenbaum asked, "looking just at the branded markets, how does the change in the volume pumped by the lessee dealers compare with the change in volume pumped by the company operated stations between 1972 and 1978?"

The Department of Energy's (DOE) study on gasoline marketing, The State of Competition in Gasoline Marketing, found an increase in the gallonage pumped by company-operated stations and a decrease in the gallonage pumped by lessee dealers. The Table enclosed with this letter and found in the Executive Summary of the study indicates that, in terms of absolute gallonage, company operations increased by 6.9 billion gallons while lessee dealers decreased by 6.4 billion gallons. The Table also indicates that branded jobbers increased their gallonage by 10.4 billion gallons. It should be noted that jobbers generally are small business entities and were able to capitalize on the anomalies of the price and allocation controls and their efficiencies as marketers to increase their volume so substantially. Also, it should be noted from this Table that unbranded sales gallonage increased during this period by 8.2 billion gallons. Therefore, while lessee dealers lost gallonage and company operations increased gallonage, larger gains were made by branded jobbers and unbranded marketers. This was the point I was making at the hearing. If the oral presentation indicated that the number of branded jobbers and independent marketers has increased during the 1972-1978 period, then the statement may be incorrect. The better statement is that these marketers increased their absolute gallonage and their market share more than company operations.

I also would like to take this opportunity to clarify further the discussion that occurred between Senator Metzenbaum and myself concerning the profitability of a company-operated station selling at retail for $1.20 per gallon, while that same refiner sold to its lessee dealer at $1.22 per gallon. Senator Metzenbaum indicated that he could not understand how the refiner-marketer could make more money by selling at the lower price. It should be noted first that Senator Metzenbaum apparently was looking at only one side of the equation. I would agree with him that, everything else being the same, a company will make more money selling at $1.22 than at $1.20. But everything else is not the same; the cost side of the equation must be considered.

At the hearing I indicated there were several reasons why the refiner-marketer had lower costs than selling through lessee dealers, including greater efficiencies and lower fixed and variable costs. Another reason, which is more compelling, was not brought out at the hearing. This reason rests on the nature of the prices charged by refiner.

Using the numbers relied upon at the hearing, the refiner-marketer sells through its company operation at $1.20. This operation more than likely is a high-volume, gas-and-go operation, selling unbranded gasoline for cash only. Although this assumption was not stated at the hearing by Senator Metzenbaum, it is the only rational one to make since I am aware of no evidence to indicate otherwise. The refiner has an internal transfer price, of let's say $1.08, to maintain consistency with the numbers used during the hearing. This internal transfer price does not include all costs to the refiner, since an additional $0.02 per gallon would be necessary to cover delivery, maintenance, and other costs. The refiner-marketer makes a profit of $0.10 per gallon.

On the other hand, the same refiner sells to its lessee dealer at the dealer tankwagon (DTW) price of $1.22. The DTW, however, includes other costs to the refiner for the branded operation, such as credit card costs (not included in the unbranded price), delivery charges, maintenance, and brand advertising (not included in the unbranded price). The netback price or actual price against which the refiner will compute its profit is lower than $1.22, probably closer to $1.17, reflecting the higher costs associated with selling branded gasoline. Using the same internal transfer price of $1.08, it can be seen that the refiner is netting only $0.09 per gallon through the lessee dealer, while the refiner is netting $0.10 through its company operation. In this way, it is more profitable for the refiner to sell through its company operation.

It should be clear that companies often can increase their profits by lowering their prices. If the quantity consumed increases by a greater percentage than the percentage decrease in the price, it follows that total revenue is greater at the lower price than at the higher price. This phenomenon is illustrated by the increasing share of the retail gasoline market accounted for by high-volume, gas-and-go operations. They maximize their profits by lowering their price and increasing their volume. The smaller margin-per-gallon is offset by the larger number of gallons sold. For example, assume one could sell 1,000 gallons per month at $1.10 per gallon and that the per-gallon margin is 10 cents, or $100 profit. By cutting the price to $1.05 per gallon, total volume increases to 2,500 gallons per month. Assuming no other factors change, the margin is 5 cents per gallon or a total profit of $125 per month. This phenomenon of lower price, higher profit currently is the driving force behind the change in marketing strategy of many refiners.

This strategy is reflected in some comments received during the course of DOE's study of gasoline marketing. Mr. Dean Walcutt, President of Certified Oil Company and a member of the Society of Independent Gasoline Marketers of America (SIGMA), said:

> The cost of operation of a retail outlet is directly dependent upon the amount of volume sold at that location. . . . Volume does affect the cost per gallon when sold through a retail outlet, whether it be a major secondary brand or a private brand station. Testimony of Dean Walcutt at the Fort Wayne, Indiana, Hearing conducted by DOE, in The State of Competition in Gasoline Marketing, Part I, Volume II (Washington, D. C.: Department of Energy, 1980), p. 49.

Major companies view the situation similarly. At the same Fort Wayne Hearing, the following interchange occurred between Mr. G. Norman Nicholson of Marathon and Mr. James Delaney of DOE:

> MR. DELANEY: Would you consider these secondary brand operations a minimum cost-type operation on a per gallonage basis?
>
> MR. NICHOLSON: Those stations compete in a segment of the market that is characterized by higher volumes and lower margins, and in order to compete in that, you obviously have to have lower costs. And so, in that segment of the market, the only way you can operate profitably with lower margins is with lower costs.
>
> MR. DELANEY: Do you have any notion of what would be the floor gallonage cost on such an operation?
>
> Would it be three cents or six cents or two cents or what per gallon?
>
> MR NICHOLSON: Most of the oil business, including the retail of gasoline, is a relatively fixed--high fixed cost--high fixed expense business, and therefore, the more volume you have, the more that you can spread those relatively fixed costs.
>
> And so, it's difficult to characterize any particular floor of any of the various expenses because there is so much related to volume. Ibid., pp. 19-20.

A third example will suffice to demonstrate this phenomenon. At the same Fort Wayne Hearing, Mr. Robert J. Thornhill, President of Thornhill Oil Company, Inc., a branded jobber and branded retailer, stated:

> It is necessary to determine what it costs to market a gallon of gasoline. In 1975, we built from the ground up,

> and direct salaried, one of the first self-service outlets in Fort Wayne. It is built for efficiency and for low cost of operation.
>
> The average marketing cost of this operation, as taken from our books for the fiscal year ending September 30, 1978 is shown on Table II. [Table not enclosed] You will note that our average direct costs of operation per gallon, operating with one cashier per shift, and open for the hours of 6 a.m. until midnight, was $3,716.92 before any depreciation, any supervisory expense, any bookkeeping expense, cost of money, or profit. This is an extremely low cost operation and probably couldn't be touched by any refinery outlet with a home office hundreds of miles away, and many layers of supervisory and accounting expense in between. If the station averaged 100,000 gallons per month the direct cost of operation would be 3.72 cents per gallon. If it did better than average and sold 150,000 gallons per month, which we did in some months, we could be competitive. The direct cost of operation averaged 2.48 cents per gallon before depreciation, any supervisory expense, bookkeeping expense, cost of money, or profit. Ibid., p. 62.

Finally, during the course of DOE's study of gasoline marketing the investigators asked various dealers to document the price disparities between the DTW price paid by the dealer and the retail price of the refiner-marketers. The evidence invariably showed that the branded dealer was referring to an unbranded refiner operated station, or to an unbranded jobber supplied and operated station. As already indicated, the cost structures of the two types of operations are substantially different. The price differentials were reasonable reflections of these different cost structures and no documented case of subsidization was found.

If there is any further information that I can provide to the Committee during its deliberations on S. 326, I will be pleased to do so.

Sincerely yours,

Leonard L. Coburn

Leonard L. Coburn
Acting Director
Office of Competition

Enclosure

cc: Honorable Howard M. Metzenbaum
United States Senate
Washington, D. C. 20510

Table ES-2

Trends in Channels of Distribution for the Largest Forty Refiners (1972 - 1978)

Change of Distribution	Relative Share 1972	Relative Share 1978	Relative Share Change	Absolute Gallonage 1972	Absolute Gallonage 1978	Absolute Gallonage Change
End Users	8.8	5.1	-3.7	8.6	5.8	-2.8
Company Stores	6.7	11.8	5.1	6.5	13.5	6.9
Lessee Dealers	36.4	25.5	-10.9	35.6	29.2	-6.4
Open Dealers	9.9	9.3	-0.6	9.6	10.6	1.0
Branded Jobbers	21.0	27.0	6.0	20.5	30.9	10.4
Unbranded Sales	11.9	17.4	5.4	11.6	19.8	8.2
Other Refiners	5.3	4.0	-1.3	5.2	4.6	-0.6

Source: Form EIA-151 data.

Note: Reported sales data are direct supplies from a refiner-supplier. Indirect sales to dealers, for example, are not reflected. Relative share is percent of total sales, while absolute gallonage is reported in billions of gallons.

Note also: Numbers subject to rounding error.

Department of Energy
Washington, D.C. 20585

November13, 1981

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

The Secretary has asked that I respond to the questions posed by Senators Laxalt, Hatch, Simpson, and East regarding S. 326, the Small Business Motor Fuel Marketer Preservation Act of 1981. The members of the Judiciary Committee are interested in receiving our views on the adequacy of DOE's Title III study, The State of Competition in Gasoline Marketing, and whether a new study should be undertaken to examine the market now that price and allocation controls have been eliminated.

With respect to the first concern, the adequacy of the Title III study, I am convinced of its thoroughness and accuracy. The Department expended a great deal of time, effort, and money on collecting the best data available on the subject of subsidization and predatory practices in gasoline marketing. Two reports were issued, a draft in May 1980 and a final report in January 1981. We followed this procedure so that we could give interested parties an opportunity to examine the draft and submit comments. As a result of the publication of the draft, we received a number of comments, some of which had great validity. As a consequence, the analysis was expanded to incorporate suggestions made by many commentors. The final report, therefore, attempts to answer most of the questions raised by the draft report. Its analysis is sound and its conclusions are valid.

The second question concerns whether another study is necessary in view of decontrol. While much has occurred in the industry since decontrol, we do not think another study is necessary. The essential facts remain similar, namely, marketing changes are occurring in order to increase the profitability of the marketing segment of the industry. While the price and allocation controls introduced many anomalies which worked to the disadvantage of lessee dealers, their ability to survive in the decontrolled market will depend on their marketing ingenuity. The allegations of subsidization and predatory practices are as hollow today as they were in the era of controls. Where instances of subsidization and predation can be documented, they should be taken to the antitrust enforcement agencies for review and appropriate action. Another study, however, will not prove or show anything new or different. Furthermore, another study will mean the collection of new data from a large number of small businesses. This would place an unnecessary burden on these small businesses for little purpose. Active monitoring of industry conditions is continuing by DOE. This monitoring is an adequate substitute for an entire new study.

I appreciate the opportunity to contribute the views of the Department during the deliberations of the Committee on S. 326. If I can provide any further assistance please do not hesitate to call upon me or my staff.

Sincerely,

Rob Odle

Robert C. Odle, Jr.
Assistant Secretary for
Congressional, Intergovernmental
and Public Affairs

cc: Honorable Paul Laxalt
Honorable Orrin G. Hatch
Honorable Alan K. Simpson
Honorable John P. East

PREPARED STATEMENT OF LEONARD L. COBURN

Mr. Chairman, Members of the Committee

I am Leonard L. Coburn, Acting Director, Office of Competition. I appreciate the opportunity to appear before you today to discuss S. 326, The Small Business Motor Fuel Marketer Preservation Act of 1981.

As the title of S. 326 indicates, the ostensible purpose of the bill is to preserve the viability of the dealer; however, it appears that the real purpose is to ensure that dealers are insulated from the competitive pressures of the free market. The primary provisions of the bill include: a divorcement of the major's refiner-operated stations, a dealer's right of first refusal for the disposal of dealer-operated stations, an antiprice discrimination provision that applies to both refiners and jobbers by requiring the use of a daily wholesale transfer price, and an open supply provision for branded dealers.

To come directly to my main point, the bill, in its present form, is ambiguous and ill-defined in several important areas; and it would not likely achieve its ostensible purpose. Even if these deficiencies could be corrected, however, the Department of Energy questions the wisdom of protecting certain business entities from the competitive process, especially in light of the existing antitrust laws and the Petroleum Marketing Practices Act (P. L. 95-297). The Department of Energy strongly opposes enactment of this legislation. Let me highlight some of the major problems of this legislation.

Competition in a Changing Environment

The gasoline market is undergoing a major transition. The market is reacting to the elimination of price and allocation controls; it is reacting to new marketing methods; and probably most importantly, it is reacting to shrinking demand, a radical change from the past. The question raised by this transition is whether the competitive process is suffering or only some competitors. It is clear that some segments of the industry are suffering during this transition period; however, it is equally clear that the market remains competitive, the competitive process is not suffering. From a competitive perspective the turbulence of the present marketplace is to be expected. It is normal for firms to enter the market in times of rising demand and firms to exit in times of shrinking demand. The proponents of S. 326 allege, however, that this process is taking place in an anticompetitive manner. Some companies, and by no means all companies, are reducing their lessee dealer operations and relying more on branded or unbranded company-operated outlets. Others are pulling out their branded operations while remaining as wholesale suppliers to jobbers. Most companies are attempting to weed out less profitable, more costly low-volume stations. Are these changes in marketing strategies anticompetitive, or do they merely reflect the companies' perceptions that these are the most efficient ways to market gasoline in a world of high-priced crude, high-cost marketing, and declining demand? It is this Department's view that there is nothing inherently anticompetitive in utilizing a lower cost channel of distribution. While we do not dispute that changing market conditions may well create severe hardships for individual competitors, we see no evidence that the overall competitive process has suffered any detrimental or anti-competitive tendencies. Government intervention as proposed by S. 326 would adversely affect consumers.

Will S. 326 Achieve Its Goal to Preserve Small Business Motor Fuel Marketers?

Open supply is viewed by the proponents of S. 326 as increasing the flexibility and competitiveness of dealers. In our view, the open supply provision will have exactly the opposite effect and perhaps lead to the demise of the branded dealer network. The primary reason for this view is that open supply undermines the supplier-dealer contractual relationship.

The relationship between branded dealers and their suppliers is based upon a contract. The goals of both the branded dealer and the supplier are similar; each wants to promote brand loyalty and consumer confidence in its product. The supplier-dealer relationship is entered into or continued only when both parties believe that this relationship, as opposed to some other method of distribution, yields the maximum long-range profits to both. Interference with this contractual relationship may have the unintended effect of making the relationship no longer profitable for one or both parties. Even if we assume that there is an inequality of power in the relationship, as many have alleged, this still does not detract from the fact that both the supplier and dealer want to maximize the value of the relationship. Suppliers have an interest in obtaining a reasonable yield on their investment, while dealers want to achieve the highest profits possible while building loyalty among their clientele.

In our view, the open supply provision may lead to fewer dealers by making the supplier-dealer contractual relationship less valuable to one party. This provision of S. 326 will mean that the profitability of a dealer network to the refiner (or the jobber) is reduced. To compensate for this reduced profitability, the dealer may have to pay higher rents or franchise fees to his supplier. If the dealer cannot operate profitably at those higher fees, we would expect dissolution of the contractual relationship. Thus, many dealers, who today have the option of staying in business or terminating their relationships with their refiner-suppliers, may find their options reduced to only termination.

At the same time that the major refiners' profitability from operating a branded dealer network is being reduced, the rivals of the branded dealer, namely, the nonrefiner chain retailers and the nonmajor refiner-marketers, are affected differently by the bill. Their marketing flexibility is increased compared to the major refiners, even more so than in H. R. 1362, the companion House bill.[*] Nonmajor refiner-marketers have been very aggressive competitors in downstream retail markets. Both nonmajor refiners and chain-retailers rely heavily upon low-price, high-volume, company-operated pumpers. Thus, the provisions of S. 326, contrary to enhancing the prospects for the preservation of individual dealers, may work in the opposite direction in two ways: (1) by decreasing the profitability of a dealer network to the supplier and (2) by increasing the relative flexibility of the dealers' most price aggressive competitors.

The principal reason that the open supply provision may lead to the demise of the branded dealer network is that the mutual benefits derived from the supplier-dealer relationship may be abrogated. The mutuality of this arrangement--the dealer getting a station with minimum up-front capital and the refiner having an assured outlet for its product--is vitiated with an open supply provision. It may become less profitable for the refiner to put the dealer into the location on the same terms as in the past, that is, up-front capital, rental payments, etc. For example, more up-front capital may be required, deterring the ability of the small businessman or businesswoman from entering the business in the first place.

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[*] H. R. 1362 places a restriction on the amount of gasoline an independent or small refiner can sell from its own refining operations, while S. 326 contains no such restriction.

S. 326 attempts to give the lessee-dealer the benefit of having a refiner finance its operations without requiring the dealer to be bound contractually to the refiner. In short, the result S. 326 wants to achieve is for major refiners to finance dealers so that they operate similarly to the independent marketers that finance their own operations. This best-of-both-worlds situation is likely to reduce major refiners' incentive to sell through branded dealers.

Divorcement

Divorcement is viewed by the proponents of S. 326 as putting the dealer on an equal footing with the supplier. We view divorcement as a drastic remedy and an unwarranted government intrusion into the marketplace with few, if any, benefits.

One alleged justification for divorcement is that somehow refiner-suppliers that market through their own retail stations are subsidizing these operations with the predatory intent of driving their lessee dealers out of business. Let's examine the facts.

In the most comprehensive and thorough study of the subsidization issue ever undertaken, DOE found no evidence of subsidization by refiners, and no evidence of predation.

- Downstream prices charged by company-operated stations were not being subsidized by revenues from upstream operations.

- Market share shifts did not demonstrate the fruits of a predatory campaign.
- Examination of internal documents found no indications of predatory intent.
- Those refiners pursuing a course of operating their own stations generally are the smaller refiners, such as Kerr-McGee, Charter, Clark, Coastal, Marathon, Conoco, Ashland, and Citgo. The largest refiners have not pursued this course to any significant extent. Therefore, it would appear that the smaller companies are trying to drive out of business the largest refiner-marketers.
- The change in operation from branded dealers to company operations is occurring only in certain areas of the country and not generally across the U. S. The upper midwest has been most affected--Ohio, Michigan, Wisconsin, and Indiana.
- It is important to note that refiner-suppliers operating their own stations have not been the major beneficiaries of the shift away from distribution through dealers. Branded jobbers and independent marketers have benefitted more--in other words, the primary beneficiaries are other small businesses that have capitalized on their inherent efficiencies.

In addition to DOE's findings, the experience drawn from elsewhere confirms that branded dealers will be no better off if S. 326 is enacted. For example, jobbers view the divorcement provisions of S. 326, without uniform wholesale pricing, as a major opportunity to move into the supplier relationship with dealers. Will dealers benefit from a relationship with jobbers? If the past is prologue, the answer is no!

The Connecticut experience with refiner divorcement is illustrative. No sooner had refiner divorcement taken place than the supplier void was filled by jobbers. Dealers found that their position had not changed, so they sponsored jobber divorcement legislation. This is a clear example where legislation started an interventionist process requiring more and more government interference without curing the supposed problem. On the federal level such a process would be a disaster to the present competitive marketplace. The meat axe approach rarely works.

The Maryland experience has been presented to this Committee as illustrative of the benefits of divorcement. It is claimed that prices are lower and the marketplace more stable. Other evidence, however, has been presented to show that Maryland's prices are no lower than other east coast cities. Maryland's data excluded both transportation charges and state taxes. Inclusion of both indicates that Maryland prices were not lower. Also, the stability of Maryland's market is questionable due to the mixing of incompatible data, the use of Maryland tax data and Lundberg data which may not rely on state tax data. It is difficult to conclude that divorcement in Maryland has had any positive benefits. In fact, the higher profit margins indicated from recent studies may be evidence of a less competitive process since higher profits result from market power.

Additional Problems

We believe that there are numerous other problems associated with S. 326 which will lead to a less competitive gasoline retail market. For example, there are several adverse effects of a mandated uniform pricing program. It could result in a much more rigid price structure at the refinery gate and eliminate competitive discounts to independent marketers, including branded dealers. This could result in reduced price competition and increased gasoline prices. In addition, we believe that the wholesale transfer pricing rules could lead to increased vertical integration. Specifically, the bill creates incentives for jobbers and nonmajor refiners to eliminate wholesale sales altogether, and to use company employees to operate their outlets instead of dealers. In this way a refiner or a jobber then can meet local competition without having to reduce its prices throughout the entire region or to all its customers.

S. 326 sets out to preserve small businesses in gasoline marketing. It is likely that this goal will not be achieved. Worse yet, if enacted, the bill could severely threaten the economic viability of the smallest actor in the industry--the single-outlet branded dealer. From this perspective, the bill is clearly counterproductive.

Will H. R. 1362 lead to another regulatory maze?

As the bill is currently drafted, a detailed analysis of its effects is difficult because of undefined terms that are subject to many conflicting interpretations. For example, the bill never defines the terms "point of transfer," "readily available," or "reasonably comparable." Another series of ambiguous terms, which may require total divestiture of major-refiner stations rather than the intended divorcement of company-store operations, are the definitions of the term "dealer" and "operate." It would be unlawful for major refiners "to operate any motor fuel service station." A dealer is defined as "a person . . . who occupies as a retailer a motor fuel service station." Operate means to engage at a motor fuel service station in the business of selling motor fuel at retail through any "person operating such station pursuant to a contract with a refiner, or person acting on behalf of the refiner or under the refiner's supervision." Would these definitions allow a dealer to "occupy" the station but make it unlawful for the dealer to "operate" the station? A more detailed examination of these ambiguities is attached to this testimony.

The one thing that is certain to result from enactment of this bill is a plethora of court actions similar to those formerly handled by the DOE. This judicial process will likely take several years before legal interpretations of all the ambiguities can be established.

In sum, once again, this bill will increase the firms' reliance on competition-in-the-courtroom and will decrease the role of competition-on-the-street. Reliance on market competition, coupled with enforcement of antitrust laws and the PMPA, are a preferred alternative to further legislative "tinkering."

Once again, to put my remarks in a broader context, the gasoline market is undergoing a major transition. This may be painful for current competitors, but it is useful for assuring the efficient distribution of gasoline. If we in the government interfere in this process, we will discourage efficiency. The loser from government intervention would be the American consumer.

Thank you. This concludes my prepared remarks. I am available for any questions you may have.

APPENDIX

Detailed Questions on S. 326

The following is a more detailed examination of the major provisions of S. 326.

Section 2(a)(1): This section requires the divorcement of the operation of service stations. The major problem is with the definition of operate in Section 2(e)(13). It is unclear under the definition, especially subsections (C) and (D), how a dealer differs from a person who has a contract with a refiner or is a person acting on behalf of the refiner.

Furthermore, nothing in this Section (2(a)(1)) or the rest of the bill discusses the disposition of stations being divorced. Could a major refiner spin off its marketing operation and form a wholly separate company (without owning a significant ownership interest) but supply that company through a long-term supply contract? Could a major refiner spin off its marketing operation and form a wholly separate company with an equity position that does not constitute a significant ownership interest? Could a major refiner sell its marketing operation to a nonmajor refiner or other supplier, which could operate it on a company-operated basis? All these potentially available alternatives can operate to circumvent the intent of this provision.

Will this section supersede or conflict with state laws that require refiner/supplier operations, e. g., along toll roads? Will this section allow for exemptions from its effect for training stations, temporary operation (if, for example, a dealer leaves an existing outlet or when an outlet is first built), or testing new marketing techniques?

Section 2(a)(2)(A): While the preceding section apparently applies only to major refiner company-operated stations, this section applies only to dealers. The term "any interest" in this section is unclear, since, for example, does it include a third party ground lease?

Section 2(b)(1): This section establishes a daily nationwide wholesale transfer price to be charged at any point of transfer. The price to be charged is to be the same whether sold to an independent wholesale purchaser or charged to the refiner-operated network.

Subsection 2(b)(2) establishes a series of price differentials that can be established by the supplier at each point of transfer based upon differences in the cost of manufacture, sale, or delivery (2(b)(2)(A)); differences based upon alternative wholesale prices charged by other suppliers of the independent wholesale purchaser (2(b)(2)(B)); and differences based upon branding services (2(b)(2)(C)).

Subsection 2(b)(3) requires a single daily wholesale transfer price for each type of motor fuel at each point of transfer, the price being the first price charged that day to an independent wholesale purchaser.

The single daily wholesale transfer price appears to be vitiated and unenforceable based upon the ambiguities introduced into this subsection. For example, what is a point of transfer? Can a transfer to a dealer where the motor fuel passes title be a point of transfer? If so, then each service station can become a point of transfer.

If price differentials based upon differences in the cost of manufacture, sale, or delivery costs are permissible, can different wholesale prices be established at each point of transfer? If the intent of the provision is to establish different wholesale transfer prices at different points of transfer, the section does not accomplish this purpose. If it does, can different wholesale transfer prices be established at a point of transfer if the product comes from different locations? How is the cost of manufacture to be determined? Is it based upon a nationwide cost, a regional cost, an individual refinery cost? If based upon individual refinery costs, then can one point of transfer served by two or more refineries have more than one daily wholesale transfer price? The same series of questions apply to cost of sale, or delivery.

Can a supplier introduce a price differential for its retailer to meet the price competition of other retailers if no price reductions are offered by others to its independent wholesale purchasers?

What is the basis for a uniform surcharge for branding charges? Is it based upon nationwide, regional, or local charges?

How can this subsection be enforced effectively? If a supplier decides to charge different daily wholesale transfer prices at a single transfer point based upon its interpretation of the allowable price differentials, will it not take some time before such a practice can be challenged?

Will a single daily wholesale transfer price, if indeed there is one, reduce the pricing flexibility in the market and tend to undercut the spot market? Will this have a negative impact upon the most price-competitive segments of the market?

Will the daily wholesale transfer price and the permissible differentials lead to price verification problems? Will attempts to verify prices violate the existing antitrust laws?

Section 2(c)(1)(A): This section establishes the concept of open supply. Does this provision supersede all state laws against commingling?

Subsection 2(c)(1)(B) permits exclusive sales contracts only if the contract contains a provision permitting open supply. How can a dealer know when it can exercise this option if it is based upon the ambiguous concepts of "not readily available from such refiner or distributor" and "upon terms and conditions reasonably comparable?"

Subsection 2(c)(2) requires that branded dealers must display point-of-sale notices to customers if it sells gasoline from sources other than the branded supplier. Subsection 2(e)(12).(B)(i) limits the definition of dealer to a lessee dealer. Does a branded open dealer have to display a point-of-sale notice?

STATEMENT OF ARTHUR E. PRICE, ADMINISTRATOR OF MOTOR FUEL INSPECTION, STATE OF MARYLAND, BEFORE THE JUDICIARY COMMITTEE OF THE UNITED STATES SENATE, ROOM 2228, DIRKSEN SENATE OFFICE BUILDING, WASHINGTON, D.C. OCTOBER 21, 1981, 10:00 a.m., RE: S.326

Mr. Chairman, members of the committee, I am Arthur E. Price, Administrator of the Motor Fuel Inspection Program for the State of Maryland. I am testifying today on behalf of Maryland State Comptroller Louis L. Goldstein. Our office is responsible for collecting the motor fuel tax and regulating the retail gasoline business in Maryland. Maryland became the first state to pass divorcement legislation, taking this step during the 1974 session of our General Assembly.

Complaints of lease cancellations and discrepancies in the quotas of gasoline allocated to different kinds of retail service stations flowed into our office and the offices of other state officials during the spring and summer of 1973.

A study conducted by our office led us to the conclusion that supplies of gasoline were being directed away from independent dealers and toward more profitable company operated stations.

The study also concluded that a clear trend toward establishment of more company operated stations, at the expense of independent dealers, was growing. A part of this trend seemed to be a lessening of full service stations and more arbitrary control over such amenities as hours of operation and credit cards.

On September 13, 1973, the Comptroller met with hundreds of retail service station dealers in Baltimore and explained to them the concept of the divorcement proposal. The legislation was introduced into the House of Delegates and the Maryland State Senate during the 1974 session. Committees in each house held public hearings and passed the bills by overwhelming majorities. Testimony at that time indicated that approximately ten percent of Maryland's nearly 4,000 service stations were company operated.

The Governor held a veto hearing to give all parties a final chance to be heard. The Bill was signed into law on May 31, 1974. Here a brief explanation of the relevant part of Maryland's law would be appropriate. Maryland's divorcement law provides that no producer or refiner of petroleum products may operate a major brand, secondary brand or unbranded service station in the State of Maryland with company personnel, a subsidiary company, commissioned agent or under a contract with any person, firm or corporation managing a service station on a fee arrangement with the refiner or producer. The stations must be dealer operated.

There is no "grandfather clause" in Maryland's law and there is no requirement for the companies to sell the service station property. The law pertains only to the operation of the service station. Further, the law as it was originally passed provided a one-year grace period for companies to find dealers.

The law was challenged in the Maryland courts and, ultimately, in the United States Supreme Court. The Supreme Court upheld the constitutionality of the Maryland divorcement law in a landmark decision handed down June 14, 1978.

In its decision, the United States Supreme Court struck down the arguments of the oil companies that the Maryland Statute was unconstitutional in light of the Sherman Act and the Robinson-Patman Act, and that it violated the Commerce and Due Process clauses of the United States Constitution. The court upheld the power of the Maryland General Assembly to enact legislation of an economic regulatory nature.

Under the Mandate of the United States Supreme Court, the State of Maryland prepared for implementation of the divorcement law. Our office required oil companies to report the locations of all company operated stations on August 1, 1978. Operation of stations was to be turned over to independent dealers by July 13, 1979. There were approximately 250 company operated stations in Maryland as of August 1, 1978.

The effects of Maryland's divorcement law have been beneficial to the consumer and to the retail service station dealer. Arguments have been advanced that divorcement causes increased prices. This spring, our office conducted a study of prices and apparent dealer margins as reported by the Platt's Oilgram and the Lundberg Letter. In comparing data for similar East coast cities - we found that in virtually every case prices reported in Baltimore were lower than the other East coast cities and the national average. In addition, considerable attention has been paid to the declining number of service stations in the nation. We saw a similar pattern in Maryland prior to enactment of the divorcement law. However, our research shows Maryland's experience is counter to the current trend. The loss of stations in Maryland has remained normal and has not accelerated. The closing of retail stations in Maryland has been approximately one-fourth the national average.

I firmly believe Maryland has lower prices and a more stable marketplace because of our divorcement law. The resulting competition among small businesses has also benefitted the consumer through improved service at the retail service station.

We have been called upon repeatedly to offer our experience to other states, and even to the government of Australia.

We in the State of Maryland would urge this committee, as we urged Chairman Bedell's committee in the House of Representatives, to insert language into any divorcement legislation which would not preempt stricter provisions of similar state statutes. Marketing conditions vary from one state to another and we would urge the committee to protect the extensive work done at the state level to meet these varying needs.

Thank you for the opportunity to testify here today.

POSTED PRICES AND DEALER MARGINS

	*Retail Average Prices	**Motor Fuel Tax Differential	Retail Price (Tax Adjusted)	*Dealer Margin
Regular Leaded				
Atlanta	$ 1.2533	-.015	1.2683	3.68¢
Norfolk	1.2656	.02	1.2456	4.30
Baltimore	1.2372	-	1.2372	2.55
Washington, DC	1.2766	.04	1.2366	4.36
Philadelphia	1.3238	.02	1.3038	5.74
Regular Unleaded				
Atlanta	1.3350	-.015	1.350	7.53¢
Norfolk	1.3248	.02	1.3048	6.25
Baltimore	1.2926	-	1.2926	4.15
Washington, DC	1.3364	.04	1.2964	6.39
Philadelphia	1.3603	.02	1.3403	5.70

* Platts/Lundberg Report, August 1981 (Self-Service)

** Commerce Clearing House, Inc. (July 1981)

NUMBERS OF RETAIL SERVICE STATIONS

	MARYLAND	REGION***	U.S.***
JANUARY 1979	3,480	57,200	170,600
MARCH 1981	3,286	46,800	136,700
NET LOSS	194 (5.6%)	10,400 (18%)	33,900 (20%)

*** Lundberg Letter, March 20, 1981

The CHAIRMAN. Our next witnesses are a panel. We have:

Griffin B. Bell, former Attorney General. He is with King & Spalding in Washington.

Dr. Philip E. Sorensen, professor of economics at Florida State University in Tallahassee, Fla.

John R. Hally, Nutter, McClennen & Fish, Boston, Mass.

As I understand it, you gentlemen are all on the same side of this question; is that right?

Mr. BELL. Yes, sir.

Mr. SORENSEN. That is correct, Mr. Chairman.

Mr. HALLY. Yes.

The CHAIRMAN. Are you all opposed to the bill?

Mr. BELL. All opposed to the bill.

The CHAIRMAN. We will be glad to hear from you.

Judge Bell, do you wish to go first?

STATEMENT OF GRIFFIN B. BELL, KING & SPALDING, WASHINGTON, D.C., REPRESENTING AMERICAN PETROLEUM INSTITUTE

Mr. BELL. I will go first, Mr. Chairman.

I will take about 8 minutes.

The CHAIRMAN. Do you have a statement you want to put in the record?

Mr. BELL. I have already submitted one—a long statement.

The CHAIRMAN. Without objection, your statement will be placed in the record in full at the completion of the oral presentations of the panel.

You can just take a few minutes and summarize.

Mr. BELL. I appreciate the opportunity to testify today on behalf of the American Petroleum Institute which opposes S. 326.

Let me summarize my three principal objections.

I have studied the bill in detail, and I believe it to be inherently anticompetitive and, therefore, anticonsumer.

To the best that I have been able to learn, the available evidence does not support the factual assumptions upon which the bill is based. In fact, the evidence seems to be to the contrary.

As a general proposition, the charge that refiners have used upstream profits from producing operations to subsidize low pump prices at company-operated stations is without foundation.

This charge of predatory conduct which is a primary motivation for the divorcement and open pricing provisions of this bill, has been analyzed and rejected by the Office of Competition of the U.S. Department of Energy.

This is not to say that there may not have been isolated instances of unfair treatment, but this type of aberrational conduct and activity exists throughout American business and is usually left to the existing law.

However, the Department of Energy specifically concluded that the difficulties faced by most retail dealers during the past decade were caused by market conditions beyond the control of the major integrated refiners.

Those market conditions include the Federal Government's regulations prior to deregulation, unpredictable periods of crude oil shortages caused by OPEC policies, high labor costs, and shifts in consumer preferences away from high-cost, full-service gas stations to high-volume, low-overhead self service stations.

That decline in full service stations has been hastened by improvements in automobile technology, a decline in gasoline consumption as mileage efficiency increases, and a growth in larger retail outlets specializing in auto products and repair services.

Both stores offer the same products and services as the full service dealer but at lower retail costs achieved through specialization—mass merchandising and related economies of scale.

In focusing upon the major oil companies, this bill therefore strikes out against wrong targets for the wrong reasons to the detriment not only of the petroleum industry as a whole but also the American consumer who benefits from lower prices that free and open competition guarantees.

At this point, Mr. Chairman, I should say that I have the greatest sympathy, respect, and appreciation for the independent dealers. I have always traded with a full service independent dealer. I want them to not only survive but prosper.

It seems to me that what I have just said ought to be the attitude of the people who own the oil companies. Based on the ones I have talked to, that is their attitude.

Second, I believe that this bill is unnecessary because it addresses the same types of anticompetitive behavior already prohibited by various Federal antitrust statutes; namely, sections 1 and 2 of the Sherman Act prohibiting contracts from culminations in restraint of trade and attempts to monopolize trade. Under that would be included predatory conduct.

Section 2 of the Clayton Act, as amended by the Robinson-Patman Act, prohibits discriminatory pricing.

Section 3 of the Clayton Act prohibits tying and exclusive-dealing contracts.

Section 5 of the Federal Trade Commission Act prohibits unfair and deceptive practices and methods of competition.

Here, again, is something that includes predatory conduct.

The Federal Trade Commission which would be empowered to issue and enforce regulations interpreted in this proposed legislation already has the necessary authority under the Clayton and Federal Trade Commission Acts and needs no additional statutory mandate to address the types of predatory conduct alleged by the independent dealers.

Any refiner who engages in such conduct would confront the prospect under section 2 of the Sherman Act of criminal prosecution as well as private litigation involving joint and several liability, treble damages, and attorney fees.

Congress enacted just 3 years ago the Petroleum Marketing Practices Act which regulates the retail gasoline franchise relationship and the sale of station property.

That law prohibits, among other things, unfair or arbitrary terminations and nonrenewals by branded refiners of gasoline station franchises.

It provides lessee dealers with a 45-day right of first refusal in connection with the franchisor's decision to close the station and sell the property.

During that period, a dealer can match the offered price of a third party—an approach which I believe is more equitable, less cumbersome, and less susceptible to abuse and potential unconstitutionality than the appraisal requirements in the sale of station provision contained in this proposed legislation.

Third, this law is single-interest legislation intended to restructure the retail petroleum market through a new form of Federal regulation at a time when the petroleum industry is just beginning to adjust itself to normal market forces.

The unfortunate fact is that the petroleum industry, ranging from refiners to retail dealers, was overbuilt to accommodate a vastly different business environment characterized by unlimited supplies of low-priced crude oil and an excess domestic refining capacity.

I acknowledge that the transition from a highly regulated to a deregulated market environment will no doubt work to the competitive disadvantage of some, especially those including retailers, wholesalers, and refiners alike.

I might say here that my information is that there is going to be just as much harm coming to the refiners as there is to these independent dealers whose businesses have profited from artificial market forces created by regulation.

The consequences of deregulation, however, will not be confined to dealers alone. They will no doubt include many others who are not seeking special help through this particular bill.

If we reinstitute the process of regulation through special interest legislation in favor of one class of competitors, and thereby interfere with the market forces which were emphasized in the recent decision to deregulate, we will soon return to a fully regulated industry with all of the unnecessary costs and inefficiencies that such regulation entails.

For this reason—notwithstanding hardships that different groups in the petroleum industry may suffer in adjusting to an unregulated market—I oppose legislation which seeks to restrict competition to relieve one segment of the market from the effects of free and open competition.

While the existing antitrust laws are intended to promote competition by allowing the market to function freely, without unreasonable interference by industry, this legislation does the reverse. I submit that there is no credible evidence that would justify insulating independent dealers from the beneficial forces of competition to the detriment of others at great costs to consumers.

I see the fundamental question as follows:

Should Congress protect the consumer by insuring that he or she receives the benefits for fair and open competition, or should it seek to protect the special interest of the independent service station operator who is suffering from economic conditions beyond the control of the targets of this legislation.

If the consumers best interests are paramount, I believe that this committee will reject this legislation because it is damaging to the consumer.

Moreover, even from the service station operator's point of view, the legislation is aimed at the wrong target. Operation of retail stations by major refiners has not been a major contributor to the service station operators' competitive difficulties.

In my statement, I mentioned all these convenience stores that have gone into the gasoline business and the smaller chain of jobbers in the gasoline business. That seems around our area to be the fastest growing way of marketing.

Thus viewed, I believe that each provision of this proposed legislation represents an attempt to strike at a problem for reasons conveniently but mistakenly laid at the feet of the major integrated refiners.

The removal or revision of any single clause will not make this bill any less objectionable since each provision is premised upon the same unsupported facts which the Department of Energy rejected in its two-volume study.

Congress should encourage and not penalize efficient integrated refiners, so long as those refiners compete fairly and openly in compliance with the antitrust and other applicable Federal laws.

Thank you, Mr. Chairman. I would be happy to answer questions.

The **Chairman**. Judge Bell, you mentioned possible constitutional problems with the sale of a station provision in the bill.

Do you see any constitutional problems with this bill in general?

Mr. **Bell**. I do not.

We have made a very careful study of the bill. The only thing that gives me pause is the sale of a station where you use the appraisal approach rather than what you have in this other law—the Petroluem Marketing Practices Act of 1978—where you get a first refusal to match the purchase price.

The appraisal business, as you and Senator Metzenbaum know, is a rather nebulous approach to setting price, because you always end up averaging. You could have a substantial loss.

I think that does raise a constitutional problem. I hasten to say that it could be cured by using the approach in the 1978 bill.

The **Chairman**. Leaving aside for the moment whether there is a need for this legislation, do you believe this is an appropriate area for Federal legislation or even for Federal preemption of State law?

Mr. **Bell**. I do not.

I think if I were in charge of making all the laws of the country—which fortunately for the American people I am not—I would require the oil companies to formulate a code of conduct in dealing with the dealers. I would put it in the contracts. Then if there was a departure from that, I would have arbitration. I would leave that in the industry.

However, if there is a need to go beyond that, I would certainly leave it to the States. One of the strengths of our country has been that each State is a separate laboratory, and we learn. If there is anything we have learned over the years, it is that we ought not to transfer too much power to Washington. We ought to leave some in the States.

I was interested in the testimony of the man from Maryland. Apparently, they have taken one approach in Maryland and another one in Connecticut. I am sure this movement is going over the country.

I do not think that by any means or in any way should the Federal Government preempt this problem or this field. I would leave it with the private sector first and the States second.

The CHAIRMAN. Judge Bell, do you believe there are any social benefits that can be gained——

Mr. BELL. Let me go back a minute.

One other thing I would do, because I have thought about this problem quite a bit, if there is some reason that the Government is not enforcing the laws against predatory conduct, I want to say that you do not have to change the law. You just have to change the policy. You can change a policy by somebody picking up the phone or writing something out. You do not need to have another law.

We are too quick to pass new laws, I think.

Excuse me.

The CHAIRMAN. Do you believe there are any social benefits that can be gained by preserving small businessman, such as the franchise service station dealers?

Mr. BELL. I do.

As I perceive it, we have four ways the consumer can get gasoline for an automobile. One of them is these small businessmen we call independent dealers. They are very important in our economy, and there is a social benefit to be gained from preserving their status.

There is also a gain for the public in keeping all of these ways of marketing—convenience stores, independent dealers, company stations, and small jobbers who usually have chains. If you took one of those away, you would have one less competitive force in the market.

This is the problem I see with this approach. I certainly would like to preserve the dealers. As I say, I have great sympathy for the dealers. I think anybody in our country is entitled to fair treatment.

As nearly as I have been able to find out, there have been a few instances of the kind of thing Senator Metzenbaum has been bringing up. I have checked that, and there has been some of that. However, it is beyond being called aberrational. It is isolated though. It does not rise above the level of being isolated as near as I can tell.

I do not condone it, however.

The CHAIRMAN. Judge Bell, the dealers claim that they are being forced out. Numbers of them have come to us and said they have been forced out. What is the simple remedy to keep these little business people alive?

Mr. BELL. Fair treatment. You run into all kinds of problems.

I will give you an example. I trade with a Phillips 66 dealer on Peachtree Road in Atlanta. His name is Pete Levine.

His property is worth a lot more than the rent he pays on it. He told me one day they had talked to him about raising the rent. He said he would have to go out of business.

I hated to see him go out of business, because I like him and he runs a good station.

I said: "Why don't you just protest it. Tell them that you will have to go out of business; you can't pay the rent."

He said: "The rent they are asking is probably less than what the property is worth, but I cannot pay it."

About 2 weeks later he said he talked with them and they decided to leave the rent as it was.

That is what I call fair treatment. If they wanted to sell the property and get the money out of it, they could do that. As long as they want to be in the gasoline business, he is doing a good job. They were fair to him.

I do not know how to replicate that throughout the industry.

I do not think you need to do it this way. I think you have the attention of the petroleum industry with this sort of legislation. It seems to me there ought to be some way to work out a fairness code.

The CHAIRMAN. You represent the petroleum industry here.

Mr. BELL. Right.

The CHAIRMAN. Could you work with them to work out a fairness code to assure these little business people that they will be protected properly?

Mr. BELL. I will be delighted to do that.

I think we have too many things in court now and in the Government. Industry ought to police itself.

The CHAIRMAN. How soon can you get this done?

Mr. BELL. I do not know if I will ever get it done, but I can talk with them.

The CHAIRMAN. The bill has been pending for some time now. There will probably be a vote here pretty soon.

How long would you want to see what you can do to protect these little business people?

Mr. BELL. I would say in 60 days I should be able to get some kind of response.

As you know, there are many members of this institute. It will take a little while, but I will do my best to get something to the chairman within 60 days.

The CHAIRMAN. We have had a lot of them come in to us, saying that they are being forced out of business.

They are disturbed and their families are disturbed. They feel that they are not getting a square deal.

It may be that the property the company owns is worth more than they can afford to rent it to them, as you mentioned in the illustration you gave.

At the same time, this is a situation which is causing social disruption here. We like to see the little business people in this country stay in business.

There are so many big businesses now that seem to have swallowed up little businesses. In the end, that is probably not best for the country.

Mr. BELL. I agree with that.

I will see what I can do. I will do my best to see if we can't get something going along this line.

The CHAIRMAN. Thank you.

Senator Metzenbaum?

Senator METZENBAUM. I assume, Judge, that if there should be any thought on the part of the chairman of delaying the markup of this bill while you do that exploring, that you would get us some commitment in the interim that there would be no rent increases, and no predatory pricing, and no changing of the credit practices. You would get all of that for us wouldn't you during that 60-day period?

Mr. **Bell**. I could not do that. I have forgotten how many members of this institute there are. I think it is about 5,000.

It is 8,000 they say.

Senator **Metzenbaum**. They are grinding these people away day by day. I think that we ought to move on the legislation. Of course, we can always stop it if and when we get some great commitment from the industry, which I doubt will be forthcoming. However, we would be willing to take a look at that.

Mr. **Bell**. One of the things that I am surprised the committee has not been able to develop is the extent of this problem. I know people come to talk to you, and I know there is some problem. However, as I say, the extent of it is not known. Is it 1 percent or half of 1 percent?

It seems to me that the maxim of equity that you ought not to fashion a remedy that is broader than the wrong is a good rule to follow.

Senator **Metzenbaum**. In order that you understand—there are not two, three, or six people protesting this subject; there are literally hundreds of them throughout the country.

I would guess that the extent is rather pervasive throughout the entire industry.

Let me ask you a question. There is a fellow you knew pretty well back in 1976. I guess you still know him pretty well.

He said that vigorous application of our antitrust laws, as well as legal restrictions on the right of a vertically integrated company to operate at the wholesale and retail levels when it is also operating in the other phases of production, refining, and transportation, have my support.

That obviously was your leader, Jimmy Carter.

In 1980, he stated:

> If elected or reelected to the presidency of the United States, I would support the passage of legislation to assure that competition in small business opportunities continue in the retail marketing of gasoline based on the concept encompassed in H.R. 6722 and S. 2798. Those were the predecessors of my bill this time.

You and he just split on this issue or did you ever tell him that you differed with him on this issue?

Mr. **Bell**. I do not recall ever having discussed it with him, but he and I frequently split on matters.

As you know, I was viewed as the House conservative by a lot of people. I do not believe in the Government regulating everything, and I do not believe in transferring all the power to Washington—to the Federal level. That is just my philosophy which I have always had.

Senator **Metzenbaum**. I do not think anybody is really suggesting in this legislation that you transfer the power to Washington. I think what they are really saying is that sometimes when a tremendous economic power in our Nation uses its economic force to squeeze out the small business community, and the small business community is truly the backbone of our free enterprise system, then sometimes the Federal Government can at least raise some concerns.

If those concerns are not heard, then you may have to use the legislative process.

You mentioned various laws that are applicable. Let me ask you a question.

You are a practicing lawyer. If you or one of the members of your firm had an opportunity to get into an open and shut case of the following:

Selling gasoline across the street for less money by the same company as the price they are selling it to the dealer;

They had increased the price to the dealer for his rent 300 percent;

They had changed his credit practices from giving him 30 days to the point where it had to be cash on delivery;

And they had instituted some other new practices—saying to him that he had to be open 24 hours a day—and so forth;

It was an open and shut case. Add to that any facts that you want.

Then somebody in your firm said: "I can get this case, but I have to take it on a contingent fee basis of 50/50."

Do you think it would be a good matter for your law firm to handle, or would you recommend against it because of the complexity?

Mr. **Bell**. I would send it to a lawyer who takes cases on a contingent fee. We do not take cases on a contingent fee. [Laughter.]

If it looked like a good case, I would find a lawyer.

Senator **Metzenbaum**. You would find him a lawyer.

Mr. **Bell**. Yes.

The fact of the matter is I would not have to take it on a contingent fee. If the dealers association wanted to employ me, they would get the money up. They are not broke.

Senator **Metzenbaum**. If the dealers association wanted to employ you in that case, would you accept that retention?

Mr. **Bell**. I would accept it if it were a case that I thought made out predatory conduct.

The first premise in your statement is not predatory conduct.

Senator **Metzenbaum**. I am not saying all of them were. Some of them.

Mr. **Bell**. I do not agree that a company should put a company station across the street from its own dealer. As near as I can tell, however, that does not violate the law.

At first, I thought it might violate the Robinson-Patman Act; but after I checked into it, I do not believe it does.

Just that standing alone would not make out a case.

The other things you added would, I think, make out a predatory conduct case.

Senator **Metzenbaum**. You think you would take that case?

Mr. **Bell**. I would give serious consideration to it.

Senator **Metzenbaum**. You suggest that changes in consumer preference——

Mr. **Bell**. I might add that I do not think the case would last long.

Senator METZENBAUM. I do not think it would either, because I think they would give up.

Mr. BELL. I think somebody would come in and say: We don't understand how this happened. It happened on a lower level and let us just settle this.

Senator METZENBAUM. It might if you were representing the plaintiff, but I am not sure they would under normal circumstances. Maybe with your prestige behind it, they would try to work out a settlement.

My guess is that it is pretty tough for a little dealer to handle a case against one of the major oil companies—just forgetting about the merits and just talking about the costs of legal fees and the ability to delay and drag out a matter of that kind.

Mr. BELL. As you know, the person who has the resources under the Federal rules can almost break you down with expense of discovery, although some of the judges now are getting onto that and are putting more restrictions on discovery that formerly was the case. It is a good trend that has started.

Senator METZENBAUM. Sad but true.

You suggest that changes in consumer preference accounted for a decline in the number of independent dealers. You are not the only one who has made this argument.

Frankly, Judge Bell, I have never quite understood that; and I do not understand it now.

Just because consumers want to buy gasoline at a station that is a high volume gas-and-go outlet—maybe self-serve and gives less service—why does it follow that that has to be owned by the parent company instead of an independent operator?

Where do you get this argument that the consumer preference takes them to the company-owned stations as compared to the independent dealers?

Mr. BELL. I do not understand how the preference started. I do not prefer to go to a self-serve, but the public seems to like that. They think they save money, and of course you do save some money.

I think that some of those are operated by dealers. There are a few around. Many of them are operated by the companies—these big huge things where you are behind a bulletproof glass and there is one person running something which looks like a computer, which I guess is a modern cash register. Everybody is putting in their own gas.

I got caught in one of those places one day. [Laughter.]

Senator METZENBAUM. That is shameful—that you had to pump your own gas.

Mr. BELL. I like to get my windshield cleaned and my oil changed and air in my tires. I hope we do not get so modern that we do not have dealers who run full service stations and who will come and start your car in the morning for you. They have mechanics and that sort of thing.

I like the old way of doing things pretty much.

Senator METZENBAUM. You know that Amoco and Shell have both testified that independents can market gasoline as well or better than the refiners.

On that basis, where do you get the idea that it is a matter of consumer preference to want to do business with the company-owned stations rather than the privates?

Mr. **Bell**. I do not think that.

I do not want to be on the record as saying that I think that.

I think the American people like to just have a place to get good service.

I would never have known the difference between the company station and a dealer except usually the dealer's name is posted.

For years the people I knew about in the oil business were really not too keen on operating company stations because they had a lot of trouble getting labor.

I testified here when I was Attorney General that I had a client who was negotiating with some oil companies to take over their stations and put in convenience food stores in those places. That later did happen.

It was just after I got asked to work on this matter that I found that there are a lot of company stations, and that they are still operating company stations.

I thought at one time that they would go out altogether.

I do not think that the public really cares who runs the place so long as it is clean and the service is good.

The only thing that will switch them off is if they think they are going to save 10 or 15 cents a gallon on gas. Then they will put it in themselves.

Senator **Metzenbaum**. Mine only give me about a 2-cent discount, Judge. I have to go down to Georgia and buy some gas.

It is 10 or 15 cents different?

Mr. **Bell**. I did not know it was so much, but one of my law partners is sitting here. Apparently his draw in the firm must be a little low because he said he had been shopping around Washington trying to—— [Laughter.]

Senator **Metzenbaum**. You have to save every penny these days.

Mr. **Bell**. He said he found a self service that was selling for 19 cents under the market.

He read a story about it I think in the paper. Maybe he is still looking for the place.

I suspect it would be hard to find it.

Senator **Metzenbaum**. Judge Bell, I am not going to take up the committee's time, because the hour is growing late and I know the chairman is trying to bring the hearing to a conclusion.

I will say that I think you may be distinguishable as being the first witness who has appeared before us on behalf of the industry indicating some concern about keeping the small independents. Others have talked about it.

We are always happy to have your testimony.

It is nice to see you again, and we are glad to have you back in Washington.

Mr. **Bell**. Thank you very much.

The **Chairman**. Thank you, Judge.

Mr. **Bell**. Thank you, Mr. Chairman.

The **Chairman**. Our next witness is Dr. Philip E. Sorensen, professor of economics, Florida State University, Tallahassee, Fla.

Dr. Sorensen, we will be glad to hear from you at this time.

STATEMENT OF DR. PHILIP E. SORENSEN, PROFESSOR OF ECONOMICS, FLORIDA STATE UNIVERSITY, TALLAHASSEE, FLA.

Mr. SORENSEN. Thank you, Mr. Chairman.

The CHAIRMAN. Would you like your entire statement to be placed in the record?

Mr. SORENSEN. Yes; I would.

The CHAIRMAN. We will do that, and you may take 10 minutes to summarize.

Mr. SORENSEN. My comments are going to be very brief.

I speak here today on behalf of the American Petroleum Institute.

I am an economist. I specialize in the economics of the petroleum industry. I have been studying the industry for the past 15 years.

My conclusion after all of that study is that the economic evidence given by concentration ratios, by levels of profitability over many years, and by levels and trends in gasoline prices over many years, as cited in my prepared statement, all show that the U.S. petroleum industry is workably competitive.

Gasoline marketing is the most competitive segment of the petroleum industry. Therefore, I can see no economic rationale for the drastic kind of legislative restructuring or the complex new forms of price regulation which would be imposed on the petroleum industry under S. 326.

As the distinguished speakers before me have noted, this country has just extricated itself from a protracted, frustrating and costly decade of gasoline price and allocation regulations.

Almost everyone in this room would agree that those regulations were a mistake. They imposed great costs on our society in terms of misallocation of resources, and they hurt rather than helped the gasoline dealers of this country—one of the groups they were supposed to protect.

I believe it would be wise to look at the new regulations and restrictions that would be imposed on the gasoline market by S. 326 in light of the failure of the recently discarded system of Federal regulations.

In particular, I would look beyond the short-run advantages which might accrue to dealers under this bill and recognize the long-run dangers the bill would pose for dealers, for consumers, and for our national economy.

The major provisions of S. 326 relate to divorcement of refiners from marketing, sale of stations to dealers, establishment of regulations on wholesale gasoline pricing, and open supply.

Without presuming to deal with these provisions in detail, because they are very complicated, let me briefly summarize my views concerning them.

DIVORCEMENT

The divorcement of large, integrated refiners from gasoline retailing would exclude an entire class of competitors from the market. It would reduce the level and the variety of competition in the market.

The refiners who would be excluded from retailing would be selected on an arbitrary basis relating to their refining capacity or their self-sufficiency in crude oil production—not on the basis of any specific anticompetitive practices.

I believe that the divorcement provisions of this bill are arbitrary and unfair and that they would most likely have a negative effect on competition.

SALE OF STATIONS

The sale of stations provision, as Judge Bell has pointed out raises serious questions of constitutional law regarding the taking of property. This provision could result in some cases in the forced sale by refiners of their property interests in stations to dealers.

The presumed goal of this provision is to keep service stations in operation. But let us suppose that a service station property has a higher and better use than as a service station. The refiner would be unable to sell to a third-party buyer for that higher and better use. But the dealer, upon buying the station from the refiner, could immediately resell to that third party and collect this higher value from the buyer.

Thus, the sale of stations provision appears to me to be both illogical and inequitable. Even if it were enacted, I would hope that the courts of our land would not sustain it.

DAILY WHOLESALE TRANSFER PRICING

The daily wholesale transfer price provisions of S. 326 are terribly complex. They would be difficult and costly to administer and to comply with. They would lead to much greater rigidity of prices. They would encourage jobbers and small refiners to increase their participation in gasoline retailing, and this would certainly be to the detriment of dealers.

This set of pricing regulations would invite a great deal of fruitless litigation.

Like other provisions of this bill, the pricing regulations would likely lead to higher consumer prices.

OPEN SUPPLY

Open supply is a superficially attractive idea. In the short run, open supply could result in some economic gains to dealers, because it would breach the arms-length contracts reached in a voluntary manner between dealers and refiners to the advantage of the dealers.

The longrun effect of open supply, however, would be to completely transform the nature of the contractual relationship between dealers and refiners. This would necessarily lead to higher rents, higher franchise fees, or other up-front costs to compensate the refiner and to restore him to a balanced position in relation to the dealer.

The system of branded gasoline marketing depends for its existence on the support of consumers and the trust of those consumers.

Obviously, consumers like branded gasoline. About two-thirds of all gasoline sold in the United States last year was sold under a major brand. Consumers are willing to pay for the extra advantages conferred by major brand gasoline.

Open supply would undercut these advantages. It would, therefore, lead to the atrophy or even the demise of branded marketing.

Misbranding, the unreliability of supply of preferred brands at dealer stations, questions of accountability, fears that inferior grades of gasoline were being passed off—all these factors would erode consumer confidence in branded gasoline.

As a practical matter, refiners might find it impossible to maintain a reliable number of outlets for their gasoline in many marketing areas. These brands would simply have to disappear from the market. With them would go the economic future of the dealers who represent those brands.

PREVIOUS EXPERIENCE WITH PETROLEUM REGULATIONS

As I said at the outset of my remarks, I believe history should be the first guide to economic policy for our Nation.

Our recent experience with Federal regulation of the petroleum industry has shown that those regulations resulted in serious distortions of the market, impairment of our national productivity, and needless administrative and compliance costs.

We should expect the same kinds of distortions and impairments of the market to occur under the system of controls and restrictions proposed in this bill.

I believe it is very significant to note that those Federal agencies with the greatest responsibility in ensuring the competitive vigor of gasoline marketing in this Nation—the Justice Department and the Department of Energy—have once again today expressed opposition to this legislation. I agree with them, and I agree with Judge Bell.

Enactment of S. 326 would be a serious mistake.

The CHAIRMAN. Dr. Sorensen, I have just a few questions.

The representative of the State of Maryland indicates that divorcement has kept dealers from going out of business without raising consumer prices. Would you comment on that assertion?

Mr. SORENSEN. I would not be surprised if divorcement had helped dealers remain in business in Maryland—at least in the short run—because it has provided them with something of a protected market.

As far as prices are concerned, it would indeed be surprising and paradoxical to economists if the result of eliminating the most price-competitive segment of the gasoline market in Maryland—that is, all of the refiners who were marketing there—was that consumer prices went down.

As other speakers have pointed out, we need additional time to study the full experience of divorcement in Maryland. We need a couple of years, in fact, to see what has happened to prices—until all the pieces fall together. For one thing, there are refiner stations still in operation in Maryland.

Nevertheless, I would point out that in the prepared remarks which I have submitted, I have compared the change in dealer margins in Maryland and the change in retail prices in Maryland, exclusive of taxes, after the date of divorcement with the change in dealer margins and the change in prices in the United States as a whole.

I did this comparing June 1979, which is the last month in which refiners could operate in Maryland, with the full year 1980. The result of that investigation shows that for all eight types of gasoline and types of service, dealer margins had risen more in Maryland and retail prices, exclusive of taxes, had risen more in Maryland than in the rest of the country.

At least for the initial period through 1980, it was true that the consumer did not gain from divorcement in Maryland.

I would expect that over time some of those dramatic increases in dealer margins and in prices in Maryland would be eroded away.

But as I said at the outset, we need more time to study the Maryland experience.

The CHAIRMAN. In your opinion, is it likely that open supply will result in customers driving into a branded dealership and not being able to obtain branded gasoline?

Mr. SORENSEN. Yes.

The CHAIRMAN. What would be the effect if legislation required the dealers to maintain an adequate supply of branded gasoline to meet the consumer demands?

Mr. SORENSEN. I think that is really what most refiners would like to see as a requirement.

If a dealer wished to carry another kind of gasoline, he could do that with unbranded gasoline.

However, flying the flag of a major refiner, he ought to be required to have available for those customers who want such products sufficient quantities of the gasolines supplied by the major refiner.

This particular version of open supply is much less pernicious than the type of provision that is contained in S. 326.

The CHAIRMAN. Dr. Sorensen, you argued that open supply will ultimately not be in the best interest of branded dealers. Do you know of any branded dealers who agree with you?

Mr. SORENSEN. As others have said, it is extremely difficult to talk to 100,000 branded dealers. They are not even talking to their association.

My evidence on this comes from informal, casual conversations with many dealers. It is something that I do as a routine matter.

Obviously, I am not putting S. 326 in front of them and asking if they agree with all these provisions.

What I have asked these dealers as I talked to them is: Does your brand give you any marketing advantage? Are you satisfied with the brand that you are operating under?

It is surprisingly true of most of the dealers that I have talked to that they believe in the brand that they sell. They want that brand to survive in the marketplace, and they feel that it gives them a marketing advantage.

To the extent that open supply would eliminate many of these brands and atrophy the others, open supply is a detrimental piece of legislation from the point of view of the dealers.

The CHAIRMAN. Senator Metzenbaum's counsel may have some questions.

Ms. BAKER. I believe in your testimony that you indicate that it is the change in consumer preferences that in part explains the decline in lessee dealerships. If that is the case, I wonder how you might explain the following:

According to DOE data, taken from the Title III study, between 1972 and 1979, if you look at the prime mover category that the DOE created and you look within that at what was going on in branded products, the volume pumped by the primary movers and independent lessee dealers fell 24.2 percent while the volume pumped by this group's open dealers, who I understand are the even smaller operators who own their stations as opposed to leasing them, increased by 1.5 percent.

Why didn't the change in consumer preference hurt these small volume mom and pop stores equally as hard? Isn't it possible that it is because the refiners do not have as much leverage over their open dealers as they do over their lessee dealers?

Mr. SORENSEN. That would be a difficult question to answer without a lot more information about the number of open dealers that were supplied by those prime movers.

My impression of the situation would be that you are starting with a very small base with open dealers.

As you say, these are often mom and pop types of operations that pump something like 13,000 to 15,000 gallons of gasoline monthly. In terms of percentage increase, a very small increase in their volume would add up to a considerable increase in their percentage share of gasoline sold.

Ms. BAKER. However, the fact is that it increased for them and decreased significantly for the branded lessee dealers. That strikes me as odd if, in fact, the reason is that there was a change in consumer preference.

Mr. SORENSEN. I do not believe that changes in consumer preferences really explain the difference you are citing—that is, between the open dealers and the lessee dealers. There would have to be another explanation.

Ms. BAKER. The change in consumer preference was, as I understand it, a fairly significant factor to you in explaining why lessee dealers have declined. All I am asking is if it is a significant fact or for lessee dealers, why would it not be a significant factor for the open dealers who also have not traditionally pumped the huge volumes?

Mr. SORENSEN. The open dealer is very often a rural dealer. The rural dealer would not be faced with the same kinds of pressures to change the form of his operation that a lessee dealer would be faced with.

A lessee dealer in a major urban area, in Ohio, for example, is going to have to come to terms with the pumper station down the block.

Ms. BAKER. I think we would have to look at the regional distribution.

Mr. SORENSEN. Yes.

Ms. BAKER. One other question, and I realize that we have some time constraints here.

You seem to suggest that there has been no trend away from lessee dealers toward company-operated outlets. Again, I do not think the DOE numbers bear you out.

If you looked at the same category of prime movers and you looked at branded operations, our calculations show that within the branded market itself there is a 30.7-percent increase in volume of gas pumped through company-operated outlets between 1972 and 1978 and a 32.7-percent decline—almost exactly the same but in the opposite direction—over the same period in the volume pumped by lessee dealers.

If you look at the entire category of 20 prime movers, as opposed to just the first category, the figures are 16.3 percent increase for company-operated stations and a 20.5-percent decline for lessee dealers. This seems to suggest that there is a trend away from lessee dealers toward company operated—at least in the category of those 20 primary movers; does it not?

Mr. SORENSEN. The point I was making in my prepared remarks was that if you look at the share of the market that was lost by the lessee dealer and open dealer categories, you will find that it is exactly matched by the share of the market that was gained over that same period of time by jobbers and independent marketers.

Therefore, businesses independent of refiners captured the very proportion of the market that was lost by lessee dealers and open dealers.

Thus, I simply do not accept the proposition that the DOE data support a conclusion that refiners have traded off their volumes for the volumes of lessee dealers or other independent businesses.

Ms. BAKER. It is just coincidence that the volume pumped through refiner-operated increased by roughly the same as the volume pumped through lessee dealers declined? Is that true?

Mr. SORENSEN. That is not true.

The volume change for the lessee dealers is much greater than the volume increase for the refiners. I can show you the numbers and make that very clear.

The volume increase for refiners was far less than the volume lost by open and lessee dealers.

Ms. BAKER. In terms of the share of the market, that was——

Mr. SORENSEN. The percentages that you quoted are coincidental. They have nothing to do with cause and effect.

Ms. BAKER. That was just coincidence.

Mr. SORENSEN. Yes.

Ms. BAKER. And it is a coincidence that it happened in all those categories.

Mr. SORENSEN. It just happens to be a coincidence. That is truly the reason.

Ms. BAKER. Thank you, Mr. Chairman.

The CHAIRMAN. That brings us to Mr. John R. Hally of Nutter, McClennen & Fish of Boston, Mass.

STATEMENT OF JOHN R. HALLY, NUTTER, McCLENNEN & FISH, BOSTON, MASS.

The CHAIRMAN. Mr. Hally, Senator Grassley is coming at 1 o'clock to continue the hearing. I have another appointment.

I am wondering if you would want to try to finish before then, or would you want to wait until he comes?

Mr. HALLY. I think that I would attempt to finish before then. I certainly am not going to take more than the 10 minutes.

The CHAIRMAN. You may proceed then.

You have a statement you want to go in the record, I presume.

Mr. HALLY. I certainly do.

The CHAIRMAN. Without objection, that will be done.

You can just highlight it very quickly.

Mr. HALLY. Thank you, Mr. Chairman.

I am an attorney in Boston. I have practiced as a trial attorney for about 30 years there, specializing in antitrust law.

In the course of that time, I have handled cases for independent gasoline marketers to a limited extent againt major refiners and cases on the other side, as well as trying other types of antitrust cases.

What I attempted to do here for the possible assistance of the committee was to analyze the adequacy of the antitrust law and trade regulation remedies to address the concerns of the proponents of this litigation.

In my paper, I express two ultimate conclusions in that regard.

One is that insofar as S. 326 does seek to remedy anticompetitive conditions in the distribution market, the existing antitrust and trade regulation laws, including the PMPA, are fully adequate to solve those anticompetitive problems. Therefore, the legislation is not needed.

My alternative conclusion is that to the extent—and I think the testimony of other witnesses has indicated that it is a substantial extent—that S. 326 attempts to achieve things other than the elimination of anticompetitive practices that it is, of course, true that the antitrust laws will not speak to such objectives.

I would suppose it is highly questionable for Congress to enact legislation so out of tune with our long history of legislation and trade regulations designed to preserve competition and not to diminish it.

For purposes of preparing the paper, I have analyzed the three major complaints which appear to evolve from the hearing record, one of which is the one which has been featured so much in the colloquy between Senator Metzenbaum and earlier witnesses today—namely, the underselling problem—the sale at retail across the street as it were at lower prices than the branded dealers' wholesale.

In my paper, I indicate that there are two hypotheses to explain that. One, there is violation of the antitrust laws—either predatory pricing by which some refiner or jobber attempts to get an undue market share by selling below cost in the short run, discriminatory pricing having the same objective, or perhaps even conspiratorial action having either of those two objectives.

The alternative hypothesis is of course that which several witnesses, including prominently General Baxter, addressed. This is namely that lower price across the street is simply the result of an existing marketing structure that permits gasoline to be distributed, particularly on an unbranded basis and on a cash-and-go basis and possibly with the addition of a pool margining approach to pricing whereby a leading grade of gas is sold at or below cost.

I would say that in cases where market structure produces gasoline across the street below the branded retailer, that it would be with great trepidation and hesitation that Congress should attempt to interfere with market structure that produce that result for the ultimate benefit of the consumer.

Staying with the first hypothesis, Mr. Chairman—namely, that there exists predatory or discriminatory practices—my thesis is that the existing statutes are more than adequate to deal with it.

I have attempted in my paper to address the adequacy of the existing remedies in somewhat more detail than in prior statements before the Congress.

In the course of the paper, I set forth cases, including recent cases, wherein conspiratorial action has been interdicted by decisions of the courts. I also discuss the available remedies.

When the situation of the lower price across the street is truly a Robinson-Patman violation, I indicate the type of case law upon which a case against that could be founded.

In the brief remaining time, I would like to note the comments in the paper which address one of the other major complaints that has come out of these hearings—namely, the disproportion of bargaining power between refiners who are on the one hand lessors and suppliers and the branded retailers on the other hand who are so dependent upon those relationships.

In this regard, I suggest that the Congress, having enacted the PMPA barely 3 years ago, ought to be hesitant to rush in with additional legislation for this one major class of American industry and commerce without giving that legislation a full try.

I point out that in the approximately 3 years since PMPA went into effect, there probably have been from 50,000 to 65,000 lease renewals that have gone through.

Yet in that period of time, there have been, according to my count, not more than 50 cases which have been brought under the PMPA. Most of those cases have been processed by the courts in a bare 6 months. Some have resulted in findings for the dealers, and some have rejected the dealers' claims of improper treatment under the language of the statute.

In either event, 50 out of 65,000 incidents of potential conflict suggest to me that the legislation which the Congress in its wisdom enacted 3 years ago is working amazingly well and is achieving a substantial success record in protecting dealers in the areas to which it is addressed.

It would be precipitate of Congress to consider moving in with such a sweeping regulatory statute before further data and a further look is obtained at just what PMPA has already achieved for the dealers.

Mr. Chairman, on the divorcement issue, I have one comment and then I will close.

I think that if big oil were to come up here with a bill which asked for a statutory prohibition on the operation of service stations by British refiners, Norwegian refiners, Dutch refiners, and Arabian refiners, that your committee would quickly sense that it was anticompetitive and objective. I do not think it would get very far at all.

The mere fact that legislation which is even more destructive in character to existing—long-existing competition—namely company stations—is proposed by small businessmen should not blind us to the fact that it is equally, when fuller analyzed, anticompetitive in nature.

That concludes the summary of my remarks, Mr. Chairman.

The CHAIRMAN. Mr. Hally, do you believe there is any evidence that jobbers are applying their wholesale discount to their retail operations in violation of the Robinson-Patman Act.

Mr. HALLY. I think there is some small evidence to that effect.

I think the recent history of regulation prevents the determination of that.

I think that in earlier phases of the industry, such cases were brought—the Federal Trade Commission *Standard Station* cases.

We then went into the era of Government regulation in which dealer margins were high and gasoline was in short supply; so even though some jobber was getting perhaps an advantage, it was not a serious or disabling advantage that caused the bringing of Robinson-Patman litigation.

I think there may be cases in which jobber stations are getting some disproportionate use of their jobber discount.

The *Sweeney* case in the third circuit which is discussed in my statement may reflect such an instance. However, it does appear in that case that the competing branded stations complained. It can be assumed that the response of Texaco in reducing the jobber's transportation allowance was partly in response to a feeling that there was a merited claim there.

The CHAIRMAN. How difficult would it be to prove such a violation if it is occurring?

Mr. HALLY. I would not want to be less than candid and say that because of what Mr. Baxter refers to as the shadow pricing problem that it would not have some elements of difficulty.

On the other hand, you would be focusing on one jobber and one limited number of stations. I think that with some cost accounting evidence and some aid from the discovery of documents which all plaintiff's attorneys have to rely on for the break in a case, that it could be done.

I do not think that it would be a multihundred thousand dollar case. It might be a case which would take well up into six figures to try.

Referring to Judge Bell's testimony, I would hope the dealers seeking to bring such a case would have the support of a dealer industry group.

The CHAIRMAN. You mentioned in your statement that there is a major refiner who permits open supply by dealers. Would you care to say which refiner that is?

Mr. HALLY. Yes.

My office represents Exxon in the eastern Massachusetts area. I was advised by their sales representatives that they do tolerate it. I would not suggest that they are overenthused about it, but they recognize it as a market reality.

I was told by my informant that they actually furnish a kit containing the sign to slip over the pump which is going to contain the non-Exxon gas so as to comply with trademark law regulations.

I may also say that particular refiner's practice has bearing on the aims of big oil, or at least of that particular company, for its dealer network.

In the last 3 years one of my real estate partners has been spending quite a bit of his time obtaining zoning permits for the renovation of some 30 or so key stations of that company in the Boston area, wherein after the permits are obtained from the various cities and towns the company is plowing $250,000 or more per station into the upgrading of them.

All but 2 or 3 of the 30 are independent stations. The dealers are to be assured the benefit of that substantial input into a branded retailer network by longer term leases.

The CHAIRMAN. Proponents of divorcement argue that existing antitrust laws are not adequate, partly because they are not vigorously enforced and partly because of the expense and difficulty of proving an antitrust violation.

How would you respond to these arguments?

Mr. HALLY. I think there is an element of difficulty certainly. You have to have a good case in this day and age before you launch into full-fledged antitrust litigation with its time and expense factor.

By the same token, if we have the flagrant cases which Senator Metzenbaum suggested are out there, I would think that—other things being equal also—they might present that type of "good case," and that such a case would be feasible to bring and to process on an acceptable cost-benefit ratio.

That is assuming that case exists.

I accept the Senator's suggestion that there are these incidents. Unlike General Baxter, I would not think that five such cases throughout the country would warrant this legislation in any way, shape, or manner.

I think that, given the hundreds of thousands of competitive situations which exist out there, that would be far too small a sample to warrant in any way this type of legislation.

The CHAIRMAN. Thank you.

Ms. BAKER. One or two quick questions on the open supply question.

You indicate on page 7 of your testimony that one could envision a decision under the PMPA protecting the dealer's right to sell a reasonable quantity of unbranded product without breaching his or her lease.

You have phrased your language pretty carefully. I assume that there is no such decision currently.

Mr. HALLY. I do not think I know of any case which permits it. There is the *Gilderhus* v. *Amoco Oil* case in which on common-law grounds—but not PMPA grounds—the court observed—and, it was an open or alternative supply case, I believe—that the refiner's tolerance of the dealer's complained-about practices for a period of time would estop the refiner from complaining about them.

No. I think the answer is that I do not know of such a case, and that is why my language was qualified.

Ms. BAKER. I guess my question to you is:

If the PMPA could be read that way, and presumably would be based in part on what Congress' intent was in passing the PMPA, what is the problem with Congress speaking unambiguously in this legislation and saying that is what we intend.

We intend the dealer to be able to go out and get a reasonable amount of unbranded product without breaching his lease.

Mr. HALLY. That certainly is a fair question.

One answer to it would be, of course, that Congress is not confining that speaking just to the open supply. It has the host of other aspects of the statute.

Directing my response, however, just to the open supply aspects of S. 326, I do point out in my paper what I found to be very disturbing in the statement of one of the proponent witnesses at the hearing before this committee in July.

He was suggesting that the enactment of that open supply provision should be deemed pro tanto an amendment of PMPA so that a dealer handling any amount of the unbranded gasoline should not be deemed to be in violation of a material term of the franchise.

If that were the case, you could have a dealer take on all the unbranded gasoline he needs; yet the signs would still be up there, the public would be misled but more importantly, his lessor refiner would not be able to terminate him and get somebody in his place to carry their brand of gas.

I think carried out over time, that would be really destructive, as other witnesses have said, of the brand relationship.

Ms. BAKER. I understand the point you are making.

My question there would be: What is the reasonable amount of quantity?

Mr. HALLY. That, of course, is a difficult question. That is why I would propose to leave it to the PMPA.

If a dealer handled 40 percent open supply to handle a tough competitive position of unbranded gasoline across the street and 60 percent of his branded gasoline supplier, whether that would be deemed compliance with his franchise and lease under PMPA, or whether it should be 70/30 or even 50/50 are the sorts of things that I think all lawyers know are best left to the so-called "common-law" approach of working it out slowly on a case-by-case basis.

The difficulty of the open supply statute is that it legislates a flat across the board thing which may do more harm before we know about it than it does good.

Ms. BAKER. The problem from the dealer's point of view, as you have acknowledged, is that it has not been established that the PMPA even covers that situation.

My question is: Assuming that you establish that it is fair in theory and concept to permit a dealer to sell a certain amount of unbranded product, then what is the harm in Congress speaking unambiguously in this legislation, even on the point that you raised?

Even to the point of saying that you leave it, under this act, on a case-by-case basis to make that determination.

Mr. HALLY. If you are suggesting only a further clarification of PMPA to permit a proportionate and reasonable amount of open supply, that would be one thing; but it would be a totally different thing than what the industry and myself as a witness have been looking at.

That is about all I can say.

It would not be the same thing.

I would oppose handling that open supply problem by the across-the-board prohibition, because I think it would be much too inflexible.

Ms. BAKER. Thank you, Mr. Chairman.

The CHAIRMAN. We want to thank you all for your testimony.

[Material follows:]

October 21, 1981

STATEMENT OF GRIFFIN B. BELL

on behalf of the American Petroleum Institute

before

The Senate Judiciary Committee

on

S. 326
(The "Small Business Motor Fuel Marketer
Preservation Act of 1981")

Mr. Chairman and Members of this Committee.

My name is Griffin B. Bell. I appreciate the opportunity to testify today on behalf of the American Petroleum Institute, which opposes Senate Bill 326. The American Petroleum Institute is an association composed of approximately 8,000 members, including more than 300 petroleum refiners and producers whose retail marketing activities would be unfairly prejudiced by this legislation.

A. General Comments

Before addressing the divorcement, sale of station, uniform pricing and open supply provisions individually, let me summarize my three principal objections to this legislation in general:

1. First and most importantly, the available evidence does not support the factual assumptions upon which this bill is based.

The charge that refiners have used upstream profits from producing operations to subsidize low pump prices at company operated stations is without foundation. This charge of predatory conduct, which is the primary motivation for the "divorcement" and "open pricing" provisions of this bill, has been objectively analyzed by the Office of Competition of the United States Department of Energy, as required by Title III of the Petroleum Marketing Practices Act of 1978.[1] After reviewing subpoenaed documents from nine major oil companies and analyzing the retail marketing practices and trends in five different metropolitan areas around the United States, the Department of Energy published its findings in a two-volume report, dated January, 1981. That report concludes as one of its "key findings" that the major integrated refiners have neither subsidized low pump prices at company-operated stations nor increased their share of the retail petroleum market.2/ The Department of Energy's data reflect that the annual increase in the relative market share of refiner-operated stations has been less than the annual increase in the relative market share of jobbers and unbranded marketers in every year since 1973. During the period of 1972 - 1980, the number of dealer-operated service stations directly supplied by refiners declined by approximately 100,000, or fifty percent.3/

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[1] 15 U.S.C. § 2841 *et seq*.

I quote from the "key findings" in the preface to the Department of Energy's report.4/

> "(2) No evidence has been developed from a detailed analysis of five SMSA's, Atlanta, Boston, Ft. Wayne, Houston, Los Angeles, using a variety of analytic techniques, that refiners are subsidizing the sale of gasoline at retail as part of a predatory campaign. To the contrary, it appears that such sales are made for pecuniary reasons and not for predatory reasons. When viewed in light of the increase in sales of gasoline to independent marketers collectively, this evidence becomes more convincing. . . ."
>
> "(4) *The price and allocation regulations of the Department of Energy are the most anticompetitive factors operative in today's gasoline market and are a driving force behind many of the trends found in this report.*" (Emphasis added.)

2/ See *The State of Competition in Retail Marketing*, Book I, *A Study of Refiner Subsidization*, (Jan., 1981) by the Office of Competition of U. S. Department of Energy, at p. xi-xii.

3/ *Id*. at p. 110, 173, 178.

4/ *Id*. n. 2 at pp. xi-xii.

Moreover, the Department of Energy specifically concluded that the difficulties faced by most retail dealers during the past decade were caused by external market phenomena beyond the control of the major integrated refiners. Those causes have included the federal government's crude oil allocation and retail pricing regulations under the Emergency Petroleum Allocation Act during the decade prior to President Reagan's deregulation order, unpredictable periods of crude oil shortages occasioned by OPEC policies, higher labor costs, and resulting shifts in consumer preferences away from high cost, full-service gas stations to high volume, low overhead, self-service stations, often owned and operated by independent private brand marketers and convenience stores. Only 3,825 convenience stores sold gasoline in the United States in 1972; in contrast, over 16,000 convenience stores sell gasoline now.[5] In addition, the Census Bureau reports that only 14,780 outlets in the United States, approximately 2% of the retail market, offered self-service pumps in 1972; it is estimated today that approximately 60 to 70% of all retail sales are made through self-service pumps.[6] Only 13 states even allowed self-service pumps in 1969; 48 states permit self-service now.

That decline in full-service stations has been hastened by improvements in automobile technology, a decline in gasoline consumption as mileage efficiency increases, and a growth in larger retail outlets specializing in auto products and repair services. Those stores offer the same products and services as the full-service dealer but at lower retail costs achieved through specialization, mass merchandising, and related economies of scale.

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[5] Id. at p. xii.
[6] Id at p. 192.

The Department of Energy thus concludes in its Report that no new legislation should be passed which affects retail divorcement, rack pricing, or open supply and that the existing antitrust laws should be relied upon to maintain fair competition in a deregulated retail gasoline market since those laws already address the alleged grievances.

In focusing upon the major oil companies, this bill therefore strikes out against the wrong target for the wrong reasons to the detriment not only of the petroleum industry as a whole but also of the American consumer who benefits from the lower prices that free and open competition guarantees. Based upon 1978 pricing and consumption data, the Department of Energy has predicted in its report that this legislation would substantially lessen competition at a cost to the consumer of approximately $18 million per month or $216 million per year in higher gasoline prices.7/ Accounting for continuing inflation since 1978, "divorcement" legislation could now cost the American consumer upwards of $286 million per year.

7/ *Id*. at pp. 238-289.

2. Second, I believe that this bill is unnecessary because it addresses the same types of anticompetitive behavior already prohibited by various federal antitrust statutes; namely, (i) Sections 1 and 2 of the Sherman Act,8/ prohibiting contracts and combinations in restraint of trade and attempts to monopolize trade, (ii) Section 2 of the Clayton Act9/, as amended by the Robinson Patman Act, prohibiting discriminatory pricing, (iii) Section 3 of the Clayton Act, prohibiting tying and exclusive dealing contracts, and (iv) Section 5 of the Federal Trade Commission Act,10/ prohibiting unfair and deceptive practices and methods of competition.

The Federal Trade Commission, which would be empowered to issue and enforce regulations interpreting this proposed legislation, already has the necessary authority under the Clayton and Federal Trade Commission Acts and needs no additional statutory mandate to address the types of predatory conduct alleged by the independent dealers. Any refiner who engages in such conduct would confront the prospect of criminal prosecution as well as private litigation involving joint and several liability, trebled damages and attorneys' fees. I am not alone in making these observations; the record reflects that representatives of the Antitrust Division of the Department of Justice and the

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8/ 15 U.S.C. A §§ 1-7. [The Sherman Act]
9/ 15 U.S.C. A §§ 12-27. [The Clayton Act]
10/ 15 U.S.C. A §§ 41-58. [The Federal Trade Commission Act]

Federal Trade Commission have consistently opposed this legislation, and its House counterpart (H.R. 1362, and H.R. 6722 in the 96th Congress - 2nd Sess.) on these and other grounds.

In addition, Congress enacted only three years ago the Petroleum Marketing Practices Act,11/ which regulates the retail gasoline franchise relationship and the sale of station property. That law prohibits, among other things, unfair or arbitrary terminations and nonrenewals by branded refiners of gasoline station franchises, and provides lessee dealers with a 45-day right of first refusal in connection with a franchisor's decision to close a station and sell the property. During that period, a dealer can match the offered price of a third party, an approach which I believe is more equitable, less cumbersome, and less susceptible to abuse and potential unconstitutionality than the appraisal requirements in the "sale of station" provision contained in this proposed legislation.

3. Third, this law is single interest legislation intended to restructure the retail petroleum market through a new form of federal regulation at a time when the petroleum industry is just beginning to adjust itself to normal market forces. As a result of President Reagan's Executive Order deregulating the retail gasoline market, we are entering a dramatically different economic period for

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11/ 15 U.S.C. § 2802(b)(2)(E)(iii).

the small, independent, and major refiners and producers in this country. The distortions of the market place that resulted during the past decade should no longer be present when a petroleum industry is influenced by competitive market forces without government regulation of price and supply.

The unfortunate fact is that the petroleum industry, ranging from refiners to retail dealers, was overbuilt to accommodate a vastly different business environment characterized by unlimited supplies of low-priced crude oil and excess domestic refining capacity. Subsequent imbalances in crude oil supplies resulting from OPEC cartel policies led to a decade of intense government regulation of price and supply to ensure the fair allocation of crude oil and gasoline supplies to all segments of the petroleum industry. We acknowledge that the transition from a highly regulated to a deregulated market environment will no doubt work to the competitive disadvantage of some, especially those -- including retailers, wholesalers, and refiners alike -- whose businesses have profited from artificial market forces created by regulation. The consequences of deregulation, however, will not be confined to dealers alone and will no doubt include many others who are not seeking special help through this particular bill. If we reinstitute the process of regulation through special interest legislation in favor of one class of competitiors and thereby interfere with the market forces which were emphasized in the recent decision to deregulate, we will soon return to a fully regulated industry with all of the unnecessary costs and inefficiencies that such regulation entails. For this reason, notwithstanding hardships that different groups in the petroleum industry may suffer in adjusting to an unregulated market, I strongly oppose legislation which, in contrast to the antitrust laws, seeks to restrict competition to relieve one segment of the market from the effects of free and open competition. While the existing antitrust laws are intended to promote competition by allowing the market to function freely without unreasonable interference by industry, this legislation does the reverse. I submit that there is no credible evidence that would justify insulating independent dealers from the beneficial forces of competition to the detriment of others and at great cost to consumers.

B. Specific Comments on Provisions of S.326

Commenting upon the specific provisions of the bill, I note the following.

1. Divorcement

Consistent with the charges of subsidization, the proposed law would prohibit the operation of retail service stations by refiners. As I have already pointed out, the charge of subsidization is not only not supported by the facts but has in fact been examined and squarely rejected by the Department of Energy's own exhaustive study. Likewise, as noted above, divorcement legislation is anticompetitive and therefore anticonsumer. There is therefore no reason to limit competition in the retail gasoline market. Accordingly, I strongly oppose "divorcement" legislation.

2. Sale of Station

I also strongly oppose the sale of station provision. As you know, it provides in essence that an owner of a gas station, who wishes to sell his station but cannot reach an agreement with his lessee dealer on a price, must sell his property to his lessee at an appraised price. In summary, if this provision is intended to produce a true fair market value, reflecting the highest and best use of the property to be sold, it is an inferior approach to the existing requirement of the Petroleum Marketing Practices Act that the lessee dealer be given a 45-day right of first refusal to purchase his station on the same terms as the owner has actually negotiated at arm's length.12/ If, on the other hand, it is intended that the appraisal procedure reflect a going concern value or otherwise produce a bargain purchase or terms for the lessee dealer, which the seller would be obligated to accept in order to sell the property, then I have grave concern as to its constitutionality. In

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12/ 15 U.S.C. § 2802(b)(2)(E)(iii)

either case, I view the sale of station provision as extremely unwise.

As we are all aware, an "independent appraisal" works better in theory than in practice as a method of establishing a fair selling price. An appraiser can only estimate value through various methods designed to reflect market value; an appraisal does not conclusively establish the real market price which can only be determined through the give and take of actual negotiations. It is possible, and indeed likely from my experience, that if two appraisers were asked to appraise the same property under the same set of analytical standards, they would develop significantly different values. In my opinion, such a provision would inject considerable uncertainty, confusion, and inequity into the sale of station properties, and it would almost certainly result in considerable litigation.

As you know, the Petroleum Marketing Practices Act of 1978 already includes a provision giving a lessee dealer a 45-day right of first refusal. In this fashion, the owner of the property can now offer his property freely to the highest bidder for the property's best and highest use, but the dealer is then afforded an opportunity to match that price on similar terms. No one could reasonably request a more accurate or equitable valuation approach.

As I suggested a moment ago, to survive constitutional scrutiny, any appraisal made pursuant to this proposed legislation must be based upon the service station property's highest reasonable market value (as opposed, for example, to its value as a going concern). Anything short of market value runs a substantial risk, in my opinion, of being an unconstitutional "taking" in violation of the Fifth Amendment of the U. S. Constitution. I am sure you are all familiar with the long line of Supreme Court cases holding that "just compensation" under the Fifth Amendment requires payment of a property's market value. Market value is in turn defined as the price for which an owner would be willing to sell his property and which a purchaser would be willing to pay after due consideration of all elements reasonably affecting value. See, e.g. Olson v. U.S., 292 U.S. 246 (1934).

The existing right-of-first refusal clause in the Petroleum Marketing Practices Act of 1978 is patterned to meet this constitutional standard for determining market value. It is obviously fair. If that is true, why do the proponents of the sale of station provision find it necessary? Is it because they hope an appraisal approach will produce lower prices? It is this implication that causes me to find the "appraisal" section in this bill very troublesome and constitutionally suspect in its ultimate application.

Finally, I would note that the bill contains no specific guidelines on the standards to be set by the Small Business Administration regarding the preparation of appraisals. Again, will the determination of value be a property's "going concern" value or "best and highest use," as I believe the Fifth Amendment to the United States Constitution requires? If the "best and highest use" is to be the standard for establishing value, the actual market value under the Petroleum Marketing Practices Act of 1978, not an appraisal, is the best approach to determining fair value.

3. Uniform Pricing

With regard to the uniform pricing provision, I again emphasize that the Sherman, Clayton and Federal Trade Commission Acts already prohibit the types of predatory conduct and discriminatory pricing that this legislation apparently seeks to address.

If this legislation were adopted, the divorcement provision would prohibit only major refiners from operating retail outlets. Therefore uniform pricing would come to bear on the small and independent refiners. Again, there is no compelling evidence that the major refiners' practices require additional regulation. There are several other reasons why I believe this provision is unsound.

First, I oppose legislation which seeks to regulate internal transfer prices within a refiner's vertically integrated business. The Robinson-Patman Act already limits price discrimination between competing purchasers of commodities. This legislation would go further, however, by imposing a transfer price on intracorporate transfers of gasoline equal to the wholesale price charged to unrelated parties. In so doing, the price of gasoline at company-operated stations would be unnecessarily inflated. Even small and independent refiners would be prohibited from passing through to the consumer cost efficiencies derived from their vertically integrated status. Again, the consumer would be the ultimate loser, since he would be forced to subsidize the price inflation that this proposal requires. Prices might be uniform, but they would also be uniformly higher for you and me as consumers.

Second, this provision raises substantial practical questions regarding the manner in which a company would account for internal transfers of gasoline, and it could well result in unmanageable enforcement problems. In this regard, I note that the representatives of the Federal Trade Commission and the Antitrust Division emphasized that the FTC could not develop effective accounting guidelines to allocate costs between a refiner's refining and marketing divisions. This legislation would just add another chapter to the morass that already exists because of the opaque and constricting policies spawned by the Robinson-Patman Act.

Finally, one of the important lessons that the American people have learned is that there are terrible costs to our national economic well-being which result from attempting to cure every small or even imagined evil with complicated regulatory schemes. This Congress and the Executive Branch are now looking hard at regulations in all areas of the government to determine whether their costs are justified by a commensurate benefit to our society as a whole. To enact another complicated piece of legislation, largely redundant with existing statutory protections, for the benefit of a small group and at the expense of the consumer, would seem entirely inconsistent with this hard-earned lesson and the actions which this Congress is now taking in other areas to remove unnecessary burdens on our free enterprise system.

4. Open Supply

The "open supply" provision could have unintended and possibly harmful consequences in failing to recognize the useful and beneficial results of many exclusive supply arrangements. Section 1 of the Sherman Act and Section 3 of the Clayton Act already prohibit unreasonable tying and exclusive dealing contracts which are likely to cause a substantial lessening of competition. On the other hand, the courts, the Justice Department, the Federal Trade Commission, and the Department of Energy have consistently recognized that reasonable exclusive dealing contracts are not only justifiable but can also be conducive to competition. For example, the construction of new service stations involves a significant capital investment, including the cost of the land, storage tanks, equipment, and buildings. The Department of Energy's Report notes that the land and construction costs of a conventional retail outlet in 1971 were approximately $207,500 and have risen to approximately $500,000 - $600,000 in 1980.[13] Exclusive supply arrangements for a reasonable length of time are therefore desirable to induce branded refiners to incur those initial start-up costs and place new stations into operation. Dealers in turn receive a degree of supply assurance together with protection against price increases and market fluctuations, as the Department of Energy has noted. Those contracts can thus be beneficial to suppliers and dealers alike. Open supply legislation, however, could ultimately have the undesired and unfortunate consequence of reducing the number of branded dealers because the economic incentive for suppliers to provide start-up capital for branded dealers would be vastly reduced. Since the existing antitrust laws prohibit unreasonable exclusive dealing contracts, there is neither a need nor an economic justification for a sweeping federal prohibition which includes business agreements that are beneficial to both parties.

Finally, this "open supply" provision not only prohibits exclusive dealing contracts but permits a retail dealer to sell another company's gasoline at a branded station. The dealer is only required to mark his pumps accordingly. This requirement, however, does little to protect the refiner's trademark. The consumer identifies the product by the building, signs on the street, the uniforms of station operators, and other familiar marketing symbols, not by the small print on the pumps. If consumers do realize that they are purchasing a different brand of gasoline, they will question the integrity of branded products and indeed the value of utilizing the services of branded stations. Dilution of brand effectiveness reduces a refiner's incentive to develop and maintain a strong branded marketing and distribution system, which has had obvious long-term benefits to dealers, refiners, and consumers alike. Why would a refiner wish to build and supervise modern, clean, efficient service stations with the significant investment costs that such development and supervision entail if the dealer can in turn purchase his product from other suppliers and simply make appropriate notations on the branded supplier's pumps?

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[13] DOE Report pp. 198-200.

In conclusion, the fundamental question is whether Congress should protect the consumer by ensuring that he receives the benefits of fair and open competition or whether it should seek to protect the special interest of the independent service station operator who is suffering from economic conditions beyond the control of the targets of this legislation. If the consumer's best interests are paramount, I believe that this Committee will reject this legislation because it is damaging to the consumer. Moreover, even from the service station operator's point of view, the legislation is aimed at the wrong target. Operation of retail stations by the major refiners has not been a major contributor to the service station operator's competitive difficulty.

Thus viewed, I believe that each provision of this proposed legislation represents an attempt to strike at a problem for reasons conveniently but mistakenly laid at the feet of the major integrated refiners. The removal or revision of any single clause will not make this bill any less objectionable, since each provision is premised upon the same unsupported facts, which the Department of Energy rejected in its two-volume study. Congress should encourage and not penalize efficient integrated refiners, so long as those refiners compete fairly and openly in compliance with the antitrust and other applicable federal laws.

Thank you.

Griffin B. Bell

COMPETITION IN GASOLINE MARKETING IN THE U.S.

Statement of Dr. Philip E. Sorensen

on S. 326

INTRODUCTION

On January 28, 1981, this nation ended a disastrous experiment in social and economic planning. For more than nine years, prices of crude oil and refined products had been controlled by various federal agencies. For seven years, crude oil and products had been allocated, supply relationships frozen, artificial distinctions involving allowable costs and allowable rates of return had been imposed--all in the hope of ameliorating an "energy crisis" which would never have been a true crisis but for the fact of the massive federal government effort to prevent energy prices from rising in the U.S.

The real effects of federal energy policies over this period were almost directly opposite to those which were intended. As a result of price controls, energy prices in the U.S. were held at artificially low levels, encouraging excessive consumption of energy and postponing necessary investments in and adjustments toward energy conservation. By stimulating demand, federal energy policies contributed to shortages of gasoline and other fuels and encouraged additional oil imports. Controls on domestic crude oil prices created wide varations in costs of refined products supplied by different refiners, necessitating further regulatory responses in the form of the crude oil buy/sell program and the entitlements program. The latter program effectively subsidized the sellers (and importers) of foreign crude oil, stimulating the demand for imported oil and contributing to the drain of wealth from the U.S. The combination of reduced incentives for domestic production of crude oil and subsidies to imports pushed up the price of imported oil to such an extent that any positive savings to consumers of gasoline and other petroleum-based products created by the price control system may have been wiped out.

The system of crude oil and refined products price controls and allocations spawned a large bureaucracy in Washington, at the state government level, and within the regulated industry. We may never know the full cost of administration and compliance for these regulations, but one estimate has put the compliance cost for private firms at $2 billion per year and the cost to the federal government alone at $210 million in 1979.[1]

One unfortunate result of these regulations is that they rewarded firms or constituencies which had the ability to manipulate the political process to their advantage. These groups found that it paid to seek rewards in Washington rather than in the marketplace. The system of price controls and allocations thus developed its own constituencies--groups which benefited from federal controls and which were quick to condemn their demise.

The service station dealer associations which are urging adoption of S. 326 would like to see the federal government once again deeply mired in regulation of the gasoline industry in the U.S. Consumer groups have not asked for S. 326; federal agencies with the most direct interest in the question of competition in gasoline marketing have testified in opposition to this kind of legislation; few economists, in my opinion, would not agree that passage of S. 326 would lead to an increase in gasoline prices in the country.

The fundamental problem with S. 326 (and similar legislation) is that it presumes that federal regulation can improve the degree of competitive performance in the gasoline market beyond the level which would be achieved under the normal workings of the market place. The fallacy in the presumption favoring federal intervention in the gasoline market is pointed out in this statement by the Department of Justice:

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[1] William C. Lane, Jr., The Mandatory Petroleum Price and Allocation Regulations: A History and Analysis, A Report to the American Petroleum Institute, May 1981, p. 163

> The petroleum industry is too complex and too dynamic to be effectively controlled by a comprehensive regulatory scheme for an indefinite period of time. In such an industry, only the self-regulating forces of supply and demand operating in a competitive market-place can adequately protect the public interest in obtaining high quality products at reasonable prices.[2]

I. MAJOR PROVISIONS OF S. 326

The substantive provisions of S. 326 are as follows:

> 1. The bill would make it unlawful for sixteen "large, integrated" refiners to operate any motor fuel service station in the U.S. "Small" and "independent" refiners (i.e., refiners with capacity not in excess of 175,000 barrels per day and refiners which obtain more than 70 percent of their total crude oil supplies from other producers) would be permitted to continue to operate such stations.
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> 2. Any property "interest" in a service station owned by a refiner, if put up for sale, would have to be first offered for sale to the current lessee dealer. The dealer would then have the right to make a counter-offer. If this price was not agreed to by the refiner, a final price (which would be binding only on the refiner) would be set by an "independent appraisal of the value of the property" under rules which would have to be developed by the Small Business Administration.
>
> 3. All gasoline suppliers (including refiners, jobbers, and wholesalers) would have to establish a "daily wholesale transfer price" for each type of motor fuel offered for sale at each "point of transfer" in the U.S. Discounts from this price would have to be justified by differences in costs of manufacture, sale, or delivery resulting from different methods or quantities in which the gasoline was sold, or by a showing that the lower price was offered to meet competing price reductions made by other suppliers. A "reasonable and uniform surcharge" could be added to the wholesale transfer price for use of a refiner's brand name or trademark.

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[2] Comments of the Department of Justice before the Economic Regulatory Administration Regarding Simplification of Crude Oil Price Controls, June 5, 1978.

> 4. Service station dealers would be given the legal right to purchase gasoline from any outside supplier unless the primary supplier of gasoline to the station was willing to sell its gasoline on terms and conditions which were "reasonably comparable" to those available from the outside supplier. The bill would require that, if a dealer bought motor fuel from an outside supplier, the dealer would have to provide "reasonable notice at the point of sale" that such motor fuel was not refined by the refiner whose brand name was displayed at the station.

A detailed evaluation of each of these major provisions of S. 326 is given in Section V, below. Two immediate impressions concerning this bill must be noted at this point, however.

First, S. 326 would legislate a degree of structural and price regulation for the gasoline marketing industry which is unprecedented in the peacetime history of the U.S., outside of the areas of public utilities and banking. Legislation of such serious import could be justified only in the face of compelling evidence of severe anticompetitive problems in gasoline marketing--evidence which does not exist.

Second, this legislation contradicts the spirit of the federal government's newly-announced commitment to deregulate the U.S. economy and leave it to the system of free markets to determine the most efficient methods of producing and distributing goods and services. The healthy competition stimulated by deregulation of airlines, trucking and communications in the U.S. stands in stark contrast to the anticompetitive spirit of this bill.

II. TESTIMONY OF FEDERAL AGENCIES HAVING ANTITRUST RESPONSIBILITIES CONCERNING THE PROPOSED LEGISLATION

If there were any substance to the argument that there are severe anticompetitive problems in the marketing of gasoline in the U.S.--problems requiring the kind of drastic governmental intervention provided in S. 326--then this legislation should have attracted the enthusiastic support of those federal agencies which have specific antitrust responsibilities in relation to this industry. In fact, all three federal agencies with the greatest responsibilities in the areas of concern addressed by S. 326 expressed opposition to this kind of legislation in testimony given earlier this year. These agencies will present further testimony concerning this proposed legislation during these hearings. It may be worthwhile, nevertheless, to review the opinions they have already expressed.

Referring to H.R. 1362, the companion bill to S. 326, the Department of Justice concluded:

> [This] bill would disrupt the functioning of the retail gasoline market and would dramatically interfere with normal market mechanisms. In our view, the bill would have serious anticompetitive effects and, if enacted, would probably result in increased prices to consumers. Accordingly, the Department of Justice strongly recommends against enactment of this legislation.[3]

While the Bureau of Competition of the Federal Trade Commission expressed "luke warm support" for the "open supply" provision of H.R. 1362, it nevertheless concluded that the proposed legislation would do more harm than good:

> Although the Bureau is concerned that the individual franchised dealer be protected from unfair methods of competition, we are equally concerned that remedies adopted to ensure competitive markets are not unduly cumbersome, ambiguous or unenforceable, and do not increase consumer prices.... Now that decontrol is here and regulatory distortions have been limited, we will be scrutinizing gasoline markets for signs of traditional antitrust violations....While we recognize that these traditional remedies are limited and may not adequately address the competitive problems that this bill attempts to correct, they appear preferable to this legislation, as presently worded.[4]

In its official testimony, the Office of Competition of the Department of Energy outlined the many inconsistencies in the legislation and pointed to the likelihood of unintended consequences in terms of consumer welfare and the survival of the branded lessee dealers themselves:

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[3] Testimony of Richard J. Favretto, Acting Assistant Attorney General, Antitrust Division, Department of Justice, before the Subcommittee on Energy, Environment and Safety Issues Affecting Small Business of the Committee on Small Business, U.S. House of Representatives, March 31, 1981.

[4] Testimony of Ronald B. Rowe, Assistant Director, Bureau of Competition, Federal Trade Commission, as cited above, March 31, 1981

> If enacted [H.R. 1362] could severely threaten the economic viability of the smallest actor in the industry--the single-outlet branded dealer. From this perspective, the bill is a hoax. The one thing that is certain to result from this bill is a plethora of court actions similar to those formerly handled by the DOE....This bill will increase the firms' reliance on competition in the courtroom and decrease the role of competition-on-the-street. Reliance on market competition, coupled with enforcement of the antitrust laws and the PMPA, are a preferred alternative to further legislative "tinkering".[5]

The conclusions reached by these federal agencies are complemented by the findings of the so-called Title III Report.[6] That study, the most comprehensive empirical analysis ever attempted of the questions of alleged predatory behavior and subsidization of company-operated stations by refiners, reached conclusions directly opposed to the assumptions which underlie S. 326. The key findings of the Title III Report are as follows:[7]

> 1. There has not been a massive movement by refiners into the direct retailing of gasoline. Based upon a detailed analysis of nationwide and statewide trends, a handful of refiners, in limited marketing areas, account for the present movement of refiners into the direct marketing of gasoline.
>
> [illegible]. No evidence has been developed from a detailed analysis of five SMSA's...using a variety of analytic techniques, that refiners are subsidizing the sale of gasoline at retail as part of a predatory campaign. To the contrary, it appears that such sales are made for pecuniary reasons and not for predatory reasons.

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[5] Statement of Leonard L. Coburn, Acting Director, Office of Competition, U.S. Department of Energy, as cited above, March 31, 1981

[6] U.S. Department of Energy, Office of Competition, Final Report: The State of Competition in Gasoline Marketing, DOE/PE-0026, Published January 1981.

[7] Ibid., Preface, pp. xi-xii.

3. Changing economic and marketing conditions are primarily responsible for the movement to high-volume, self-service stations and away from the low-volume, full-service network. Changing consumer preferences, increasing operating and construction costs, [changes in] crude oil markets, and competition from independent marketers were the driving forces behind these changes.

4. The price and allocation regulations of the Department of Energy are the most anticompetitive factors operative in today's gasoline market and are a driving force behind many of the trends found in this report.

The real questions to be considered in evaluating S. 326 are these: Is the gasoline market in the U.S. effectively competitive? How would S. 326 affect the efficiency and productivity of the U.S. economy? And how would consumers be impacted by this bill? I will address these questions in the sections which follow.

III. IS THE PETROLEUM INDUSTRY IN THE U.S. COMPETITIVE?

The crux of most of the arguments which assert the necessity for extraordinary legislative intervention into gasoline refining and marketing, such as S. 326, is that the U.S. petroleum industry is not competitive. This assertion, which may have gained credence from the Standard Oil case of the early 1900's, has been repeatedly contradicted by many recent studies of the industry carried out by academic experts and federal government agencies.[8]

The major indicators of competitive market structure and performance are given by (a) concentration levels and trends; (b) levels of profitability in comparison with all U.S. industry; and (c) trends in the real price of gasoline over the past three decades. All of these indicators point in the direction of a competitive industry. The evidence is as follows:

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[8] In addition to the Title III Report, Ibid., see T. Duchesneau, Competition in the U.S. Energy Industry, A Report to the Energy Policy Project of the Ford Foundation, Cambridge: Ballinger, 1975; Federal Trade Commission, Economic Report: Concentration Levels and Trends in the Energy Sector of the U.S. Economy, March 1974; R. Jones, W. Mead, and P. Sorensen, "Free Entry into Crude Oil and Gas Production and Competition in the U.S. Oil Industry," Natural Resources Journal, October 1978; and J. Markham, et al, Horizontal Divestiture and the Petroleum Industry, Cambridge, Ballinger Publishing Co., 1977.

1. Concentration Levels and Trends

Concentration ratios measure the proportion of an industry's sales capacity, or reserves which are controlled by the largest firms in the industry. The most commonly used concentration ratios are those for the top four and the top eight firms in an industry. These ratios reflect the general view among economists and antitrust authorities that intensity of competition is related to the number of firms in the industry and the size and stability of their market shares.

Concentration ratios for the major sectors of the U.S. oil industry are reported in Table 1. For comparison, concentration ratios (averages) are also reported for 292 U.S. manufacturing industries. The most striking conclusions to be drawn from the data in Table 1 are:

a. both the four-firm and the eight-firm concentration ratios for all sectors of the U.S. petroleum industry have significantly fallen over the period 1970-72 to 1979 (the last year for which complete data are available).

b. compared to all U.S. industry, concentration levels in the U.S. oil industry are much lower at the four-firm level and about the same at the eight-firm level.

The hypothesis of monopoly power is not supported by the data in Table 1. Indeed, these data show that competitive pressures within the oil industry have increased rather than decreased over the past decade.

2. Rates of Profitability

If an industry possesses monopoly power, that power should be reflected in sustained higher-than-average rates of return on stockholders' equity (the most widely-accepted measure of profitability for an industry). Rates of return for the oil industry are compared to rates of return earned by all U.S. industry over the twenty-one year period 1960-1980 in Table 2. The data indicate that the oil industry has earned a slightly higher rate of return than all industry

Table 1

Concentration Ratios for Major Sectors of the U.S. Oil Industry and for 292 U.S. Manufacturing Industries

	Top 4 Firms ($ of Total)	Top 8 Firms (% of Total)
U.S. Crude Oil Production (1979)[1]	23.8	40.2
(1970)[1]	26.3	41.7
U.S. Crude Oil Reserves (1979)[1]	35.7	53.2
(1970)[2]	37.2	63.9
U.S. Refining Capacity (1979)[1]	29.7	50.3
(1970)[1]	32.5	57.5
U.S. Refinery Runs (1979)[1]	31.0	55.0
(1970)[1]	34.2	61.0
U.S. Refined Product Sales (1979)[1]	29.3	49.1
(1970)[1]	34.0	57.3
U.S. Motor Gasoline Sales (1979)[3]	28.8	49.8
(1970)[3]	30.7	54.6
292 U.S. Manufacturing Industries (1970)[4]	41.5	54.3

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[1] For detailed explanation of Data Sources see: *Market Shares and Individual Company Data for U.S. Energy Markets: 1950-1979*, Discussion Paper #014R, American Petroleum Institute, October 30, 1980.

[2] T. Duchesneau, *Competition in the U.S. Energy Industry*, Ballinger, 1975, p.39.

[3] Market share data from the Lundberg Survey, as reported in *National Petroleum News Fact Books*.

[4] W. Mueller and R. Hamm, "Trends in Industrial Market Concentration," *Review of Economics and Statistics*, Nov. 1974, pp. 511-20.

Table 2

A Comparison of Rates of Profitability
in the U.S. Oil Industry as Compared
to All Manufacturing Industry
1960-1980

	Rate of Return on Equity (%)	
Year	Petroleum Industry	All Industry
1960	8.6	9.1
61	8.4	8.3
62	8.5	8.9
63	9.5	9.1
64	9.0	10.5
1965	10.4	11.8
66	12.3	12.7
67	11.2	11.3
68	11.8	11.7
69	10.5	11.3
1970	10.3	9.5
71	9.0	9.1
72	9.4	10.3
73	13.4	12.4
74	16.8	13.6
1975	11.9	11.6
76	13.0	13.3
77	13.1	13.5
78	13.4	14.3
79	19.1	15.9
1980	19.4	14.4
Average, 21 years	11.86	11.55

Source: Fortune Magazine, Directory of the 500 Largest U.S. Industrial Companies, Issues Dated 1961-1981 on average over this period. The oil industry rate of return was higher than the all-U.S.-industry rate of return in only nine of the twenty-one years noted, however, and was significantly higher than the U.S. average in only three years (1974, 1979 and 1980) when serious external oil "shocks" produced short-run inventory profits for all holders of crude oil. The higher level of profitability the industry achieved in 1974 was eroded by the forces of competition in 1975-1978, and we may expect that this will be true in the current period as well.

These results strongly support the conclusion that competition is working in the oil industry; they do not support the belief that the oil industry operates in a monopolistic fashion.

3. Trends in the Real Price of Gasoline

An industry characterized by monopoly achieves an excessive level of profit by means of restrictions on output which lead to increases in consumer prices. High and inflexible consumer prices which fail to reflect changes in business conditions or in costs of production are expected characteristics of monopoly. The history of price behavior in the U.S. gasoline market, however contradicts the model of monopoly pricing.

Over the years 1950-1972, gasoline supply in the U.S. rose at a rate of about 3 percent per year, much more rapidly than the rate of population growth. At the same time, the real price of gasoline (or the market price with the effects of general inflation removed)net of taxes, fell at an average rate of about 1.5 percent per year.

The real net-of-tax price of gasoline in the U.S. was 26.7¢ per gallon in 1955 (using the base year 1967=100). This price had fallen to 19.5¢ per gallon in 1972. Despite the ten-fold increase in the price of imported crude oil brought about by the 1973 Arab oil embargo and the 1978 Iranian crisis, the real net-of-tax price of gasoline in the U.S. was only 42.5¢ per gallon in 1980 (see Table 3). Most experts predicted sharp increases in gasoline prices in the wake of President Reagan's decision to decontrol domestic oil prices in January of 1981. In fact, gasoline prices are lower today than they were at the time of the decontrol decision. This result would not be expected in an industry dominated by monopoly power. It occurred as a result of competition in the marketplace.

In summary, the factual evidence provided by a study of levels and trends in concentration ratios, profitability, and real prices for gasoline contradicts the assumption that the U.S. oil industry is monopolistic in its structure or its performance. There is no justification in economics, therefore, for the kind of extraordinary structural remedies proposed in S. 326.

IV. WHAT IS THE CAUSE OF THE DECLINE IN THE NUMBER OF FULL SERVICE GASOLINE STATIONS IN THE U.S.?

Some supporters of S. 326, while agreeing that the U.S. oil industry has achieved significant efficiency through economies of scale and that consumers have enjoyed lower prices for gasoline as a result of these productions efficiencies and the open competition of sellers in the marketplace, nevertheless believe that some Congressional action is needed to protect the small businesses which appear to be threatened by the changes in the gasoline market which have taken place since 1972. In part, these fears concerning the future of gasoline dealers have been stirred by exaggerated claims and assertions made by supporters of refiner divorcement.

The best estimate of the actual numbers of retail gasoline outlets in the U.S. in 1973 and in 1980 are given in the Title III Report. These numbers are

Table 3.

Trends in Gasoline Prices and Dealer Margins in the U.S.
(Real Values in 1967 Cents for Leaded Regular Gasoline)

	Wholesale Price (DTW)	Dealer Margin	Retail Price Exc. Taxes	Retail Price Inc. Taxes
1955	20.17	6.54	26.71	36.25
1956	20.05	6.45	26.50	36.77
1957	19.80	6.43	26.23	36.73
1958	18.73	6.06	24.79	35.08
1959	18.43	5.83	24.26	34.93
1960	18.13	5.54	23.66	35.10
1961	17.63	5.28	22.91	34.33
1962	17.05	5.42	22.47	33.82
1963	16.60	5.33	21.93	33.17
1964	15.95	5.55	21.51	32.67
1965	16.28	5.63	21.90	32.96
1966	16.29	5.91	22.19	33.00
1967	16.31	6.24	22.55	33.16
1968	15.84	6.16	22.01	32.35
1969	15.58	6.14	21.72	31.73
1970	15.20	5.91	21.11	30.69
1971	14.93	5.85	20.77	30.03
1972	14.14	5.38	19.52	28.83
1973	14.64	5.56	20.20	29.17
1974	20.67	6.69	27.36	35.48
1975	22.20	6.00	28.19	35.50
1976	22.87	4.96	27.82	34.88
1977	23.42	4.51	27.93	34.75
1978	22.79	4.38	27.17	33.63
1979*	28.52	5.03	33.55	39.77
1980*	38.05	4.42	42.47	48.28

All values deflated by the U.S. Consumer Price Index, with 1967=100.
*Self-service ratio weighted at 50 percent.

Sources: Platt's Oil Price Handbook, 1978 ed., p. 106, and 1979 ed., p. 71; National Petroleum News Factbook Issue, Mid-June 1981, p. 94.

much higher than those reported in the U.S. Department of Commerce's Census of Retail Trade (and which are published in the National Petroleum News Factbooks each year) because the Department of Commerce data include only those retail outlets which obtain 50 percent or more of their income from the sale of gasoline and related products. The Department of Energy's estimates include both primary and secondary retail outlets, including convenience stores and other sellers for whom the sale of gasoline is not the primary source of income. This more accurate count of stations is reported in Table 4. As indicated in Table 4, the total number of retail outlets for gasoline had fallen by 31 percent from 1973 to 1980, but nevertheless still stood at 229,500 outlets--a count which is 71,000 higher than that reported in the 1981 National Petroleum News Factbook (p. 109).

No one can deny that there has been a significant decline in the number of service stations in the U.S. over the past decade, but it also should be noted that this decline was needed to adjust to the changes in the marketplace which occurred over this period. Even the principal author of the widely-distributed 1980 report which pointed to "the impending destruction of small business in the gasoline industry,"[9] had concluded that the industry had an excessive number of stations in 1972:

> Anyone familiar with...gasoline marketing will admit that there are far too many stations. When the available gasoline business is divided among them, few stations can reach efficient levels of manpower and facility utilization. The result is low labor productivity and low profitability.[10]

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[9] Fred Allvine, J. Houston, and O. Phillips, The Case for Legislative Relief from the Impending Destruction of Small Business and Competition in the Gasoline Industry, a report published January 22, 1980 (rev. February 1980).

[10] F. Allvine and J. Patterson, Competition, Ltd.: The Marketing of Gasoline, Bloomington, Indiana: Indiana University Press, 1972, p. 4.

Table 4.

An Estimate of Number of the Primary, Secondary, and Jobber Supplied Retail Outlets

	Private Research Company Estimate of Retail Outlets				
Year	Total	Primary	Secondary	Refiner Supplied Outlets	Estimate of Jobber Supplied Outlets
1973	332.9	215.9	117.0	201.6	131.3
1974	302.1	196.1	105.9	185.5	116.6
1975	288.7	189.5	99.2	178.5	110.2
1976	279.4	186.8	92.6	159.8	119.6
1977	264.4	177.4	87.0	144.4	120.0
1978	252.2	172.3	79.9	131.4	120.8
1979	240.2	164.8	75.5	120.1	120.1
1980	229.5	158.5	71.0	110.8	118.7

Note: Estimate for July each year in thousands of outlets. The source of the private estimate is confidential. Number of refiner-suppied outlets is from Form P-306. Preliminary research suggests that refiner data for the years 1973-1975 may be slightly overstated. The purpose of this table is to suggest the number of non-refiner supplied retail outlets.

Note also: Rows may not add due to rounding.

Source: Title III Report, Table 6-6, p. 177.

The number of service stations rose rapidly during the 1960's because of the nearly universal expectation in the industry that the gasoline market would continue to grow at a high rate through the foreseeable future. Refiners expanded their retail networks into new areas of the country in order to participate in this expected growth in the market and to capture economies of scale in refining and distribution. As has been true of many other industries, oil companies made investments in refining and marketing on the basis of projections of the demand for gasoline which later proved to be incorrect.

As the realization grew that the gasoline market was not likely to grow at a rate which would accommodate the current and planned levels of marketing investments, the major refiners began to retrench. Data from 28 large refiners show that these companies deactivated more stations than they constructed in 1968 and the years thereafter.[1] These adjustments to the revised expectations concerning the growth of the gasoline market began well in advance of the crude oil supply disruptions of 1973-74.

The reasons for the decline in the number of conventional retail gasoline stations in the country in the period after 1972 include the following:

1. The rise in the availability and popularity of self-service gasoline (which now commands over 60 percent of the market in the U.S.). The availability of gasoline on a self-service basis affected both the supply and the demand side of the gasoline market. On the supply side, self-service reduced the cost of marketing gasoline. A single multi-pump outlet could sell a much greater volume of gasoline while employing only one or two cashiers. On the demand side, self-service offered lower prices and savings of time to the buyer.
2. Changes in the design of automobiles which reduced the need for routine maintenance services (such as oil changes and chassis lubrication) but which increased the demand for more specialized automotive services, together with the growth of new industries supplying these specialized services (such as tune-up shops and tire stores).

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[1] "Recent Changes in Retail Gasoline Marketing," American Petroleum Institute, Washington, D.C., January 1981, p. 3.

3. An increase in the willingness of car owners to perform automobile maintenance tasks on a "do-it-yourself" basis.

4. Skyrocketing real estate prices and labor costs which made low-volume service stations uneconomic.

These changes, representing shifts in the tastes and preferences of consumers and in the costs of station operation, reduced the economic advantage of the full-service station in comparison to the high-volume self-service station in the gasoline market. An additional factor affecting the attitude of consumers was the experience of the gasoline shortage periods of 1973-74 and 1979. During these periods, many full-service stations were closed on evenings and weekends and, when open, failed to offer such expected services as windshield cleaning and oil level checks. These changes in the hours of operation and in the quality of services offered induced many consumers to move their business to high-volume "pumper" stations, which were open for longer hours and which offered lower prices.

One of the issues which was studied in the Title III Report was the charge that the major refiners had used the gasoline allocation system to divert product from their dealers to their refiner-operated stations. This belief is not supported by the record of annual changes in the relative shares of various classes of trade for the 28 largest refiners (as shown in Table 5). While the share of gasoline sales made through company-operated retail outlets rose from 6.6 percent in 1972 to 11.0 percent in 1979, the share of these refiner-direct outlets remained unchanged in 1977-78 and actually fell in 1978-79. The decline in the market share of dealers supplied directly by refiners (from 50.7 percent to 36.9 percent of the market between 1972 and 1978) was matched almost exactly by increases in the shares of other independent businesses such as branded jobbers, whose share of the market rose

TABLE 5.

ANNUAL CHANGES IN THE RELATIVE SHARE OF VARIOUS CLASSES OF TRADE FOR THE 28 LARGEST REFINER-MARKETERS OF GASOLINE

Channel of Distribution	Relative Share 1972	Annual Changes in Relative Share							Relative Share 1979
		1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	
Direct Sales to End Users	9.6	-0.4	-0.2	-0.5	-1.3	-0.6	-0.9	0.0	5.7
Company-Operated Retail Outlets	6.6	0.8	0.2	1.3	1.3	1.0	0.0	-0.3	11.0
Dealers, Supplied Direct by Refiner	50.7	0.7	-3.2	-4.7	-2.5	-1.3	-1.9	-0.9	36.9
Sales to Branded Jobbers	20.9	0.6	0.3	2.1	1.8	0.0	1.3	1.0	28.0
Unbranded Sales to Independents	12.1	-1.7	2.8	1.8	0.6	1.0	1.5	0.2	18.4

Note: The 28 largest refiner-marketers of gasoline were identified using Form EIA-151 data for 1978 total gasoline sales. The refiners include Exxon, Shell, Amoco, Texaco, Chevron, Mobil, Gulf, Arco, Hess, Union, Sun, Sohio/BP, Phillips, Conoco, Ashland, Marathon, Citgo, Getty, Coastal States, Fina, Kerr-McGee, Champlin, Clark, Tenneco, Crown, Total, Tosco, and Charter. Individual numbers subject to rounding error. Commission agent sales are considered as sales made by the refiners.

Note also: Sums may not add due to rounding error.

Source: FEA-P306-M-O, Refiner/Importer Monthly Report of Petroleum Product Distribution for years 1975-1979 and FEA-P305-S-O, Refiner/Importer Historical Report of Petroleum Product Distribution for years 1972-1974. (Hereafter P-306 data).

Source of Table 5: Title III Report, Table 4-1, p. 111.

from 20.9 to 28.0 percent, and unbranded independents (mostly chain retailers), whose share rose from 12.1 percent to 18.4 percent.

The reasons for the large growth in the jobber/chain retailer segments of the industry, and the concomitant decline of the segment composed of dealers supplied directly by refiners, are largely connected with the changes in consumer buying patterns noted above. But there is no doubt that federal regulations in effect in the period after 1973 hampered the ability of dealers to achieve volume growth and to compete effectively in pricing with jobbers. The Department of Energy, after analyzing the effects of federal price controls, allocations, and other regulations affecting sellers of gasoline, concluded that these regulations were "the most anticompetitive factors operative in today's gasoline market."[12] This conclusion should be given serious attention before any new regime of federal regulation of gasoline marketing is approved.

While the decline in the number of dealer-operated service stations in the U.S. since 1972 has been almost universally lamented, it is instructive to look at what would have happened to the average volume of sales of present dealers if these marginal, low-volume stations had not closed. Assuming that the average volume of sales at dealer stations had remained unchanged at the 1972 level, dealers in 1980 would have sold 27,150 gallons per month rather than 43,800 gallons per month--the actual 1980 average volume for dealers.[13] Even assuming that this greater number of stations would not have resulted in any lowering of the average retail margin on gasoline sales in 1980, the smaller volume of sales at each station would have reduced the average income earned by dealers by about $1,930 per month or about $23,160 per year in 1980.[14]

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[12] Title III Report, pp. 213-234

[13] Based upon DOE volume data. See the Title III Report, p. 173

[14] Computed using a 50 percent ratio for self-service, from retail margins reported by the Lundberg Survey. See National Petroleum News Factbook Issue, Mid-June 1981, p. 94.

It should be obvious that the economic position of today's dealers has been greatly improved by the closing of many of the low-volume, marginally profitable stations which were in business in 1972. But the principal beneficiaries of the improvements in marketing efficiency achieved by reductions in the number of stations and increases in their average volume of sales are the consumers of America, who otherwise would have had to pay higher prices to maintain an inefficiently large number of sellers in the gasoline market.

As in other U.S. industries, the decision as to how many firms of what size and what character should survive in the gasoline market ought to be made by the impartial forces of competition--the interaction of consumer preferences and the economic factors which affect relative costs. There will always be an important place in a freely competitive gasoline market for the dealer-operated full-service station. A large proportion of American consumers prefer to receive the additional service, credit facilities, and guarantee of product quality which is uniquely associated with the major brand dealer. In a market unfettered by government restrictions on supplies and prices, each channel of distribution for gasoline will succeed in direct proportion to its ability to satisfy a consumer demand. The federal government would be taking on a most unnecessary and fruitless burden if it were to assume that it can decide better than the American consumer what mix of marketing styles should be available in the gasoline market of the future.

V. AN ECONOMIC ANALYSIS OF S. 326

The significant provisions of S. 326 relate to (1) divorcement of major refiners from the retailing of gasoline; (2) sale of refiners' property interests in service station to lessee-dealers; (3) wholesale transfer pricing of gasoline; and (4) "open supply". Each of these provisions is evaluated in terms of economic effects in the sections below.

1. Divorcement

S. 326 would prohibit any "large, integrated" refiner from operating a motor fuel service station in the United States. "Independent" and "small" refiners--defined as refiners who obtain more than 70 percent of their total crude oil supply from other producers and companies whose total refining capacity does not exceed 175,000 barrels per day--would be exempted from the divorcement requirement.[15]

The exclusion of an entire class of competitors from the market would reduce the level of competition and lead to higher consumer prices. The probability of success in any attempt to fix prices in a market is much reduced when the competitors are heterogeneous in character. Any attempt by dealer associations at the state and local level to encourage their dealer-members to adopt a policy of higher gasoline prices, is unlikely to succeed, largely because of the presence in the market of non-dealer sellers such as refiners and independent marketers. Because divorcement of major refiners from marketing would reduce the heterogeneity of the competitors in the U.S. gasoline market, it would be likely to lead to higher consumer prices.

The theory behind divorcement of major refiners from marketing is that these refiners have subsidized their company-operated stations in an attempt to drive their dealers out of the market.

Subsidization as part of a strategy of predatory pricing would make economic sense only if the potential gains to be reaped in future years (when monopoly prices could be charged) exceeded the present losses which would be incurred.

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[15] The companion bill to S. 326 (H.R. 1362) would impose a "refiner sales ratio" on these refiners in an attempt to limit the growth of gasoline sales by these refiners through their company-operated stations. Oddly enough, these refiners would be able to expand their retail sales without limit by means of purchases of gasoline from other suppliers. Thus this provision would amount to nothing more than legislated inefficiency, denying these refiners the economies associated with vertical integration and leading to higher retail prices.

Given free entry into gasoline retailing, and in view of the probability of antitrust action to correct for any acquired monopoly power, a predatory pricing strategy would be highly unlikely. One must wonder, as well, why the major refiners who have invested billions of dollars in a distribution system based upon independent dealers and jobbers would seek to destroy the very businesses whose success is so obviously critical to the success of the refiners themselves.

In any case, the findings of the Title III Report, the most painstaking study of the question of refiner subsidization yet attempted, have clearly refuted the hypothesis of predatory pricing by the major refiners. After studying this issue using a variety of analytical techniques, the authors of the Report concluded that "refiners are more than covering the incremental costs of marketing gasoline through their company stores," and that where refiners have increased their operations at the retail level, this was done "for pecuniary reasons and not as a predatory device."[16]

The other side of the predatory behavior argument, the allegation of "predatory costing" by means of unjustified increases in dealers' rents, can be shown to be equally without merit. The most important factor in the rise in dealers' rents over the past five years has been the ending of the freeze on the level of rents which was imposed by the federal government in August of 1971 and not removed until November of 1975. This freeze coincided with the period of some of the most rapid inflation in U.S. history and with a rise in the level of interest rates to historic highs. Since all property-related costs such as taxes, ground rents charged by third parties, and maintenance costs had risen along with the general price level in the years after 1971, it would be expected that rents charged by refiners would also rise.[17]

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[16] Title III Report, p. 68.

[17] Costs of new service stations have reached the half-million dollar level, according to a story published in the National Petroleum News, August 1980, p. 56.

The issue of "predatory costing" by refiners in the setting of rentals for service station properties was evaluated in the Title III Report. Comparing rentals charged by refiners in five U.S. cities with the rentals required to achieve a "breakeven" return on investment in the dealer-operated stations involved, the Title III Report concluded that in 14 or 15 of the 17 cases studied, the actual rentals charged by the refiners were lower than the "breakeven" rentals required to earn 12 percent on the estimated value of these stations.[18] This analysis is confirmed by many recent stories in the financial press, suggesting that U.S. refining companies are earning below-normal returns on their investments in marketing properties.

The U.S. has only limited experience with the effects of refiner divorcement from retail marketing, but the experience to date suggests that consumers have a great deal to lose if divorcement is mandated on the national level. Following the decision of the U.S. Supreme Court in the case of Exxon, et al. v. Maryland (1978), the state of Maryland proceeded to enforce its 1974 statute providing for the divorcement of all refiner-operated service stations. Some 248 stations which were company-operated prior to the Supreme Court's decision were affected. While most of these stations were converted to dealer operations, 36 were closed as of April 1981 and a few others still remain in operation by refiners pending legal appeals.

In testimony favoring H.R. 1362, the companion bill to S. 326, Louis I. Goldstein, Maryland State Comptroller, attempted to justify Maryland's divorcement statute by comparing the absolute levels of retail prices for unleaded regular gasoline in Baltimore with prices in four other cities and the U.S.

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[18] Details of this analysis are reported in the Title III Report, pp.180-82

average price over the period June 1960 to February 1981.[19] Such a method of comparison, however, is totally invalid as evidence of the price effects of refiner divorcement in Maryland. Differences in levels of state and local taxes and differences in the wholesale cost of gasoline in the different cities cited by Mr. Goldstein are sufficient to explain the differences in levels of retail prices in those cities. The time period chosen for these comparisons is also not a relevant one.

A more logical method of assessing the impact on consumer prices of divorcement in Maryland would be to compare relative changes in retail prices (excluding taxes) or in retail margins which occurred in Maryland and in the U.S. as a whole in the period following the final effective date of divorcement in Maryland. Unfortunately, price and margin data are available only for Baltimore, but these data may be presumed to be representative of changes in prices and margins which were experienced in Maryland generally.

The final date for refiner divorcement of service stations in Maryland was July 13, 1979. Thus the base month used for comparison is June 1979--the last full month of operation prior to divorcement. Eight categories of gasoline sales are reported in Table 6 for Baltimore and for the U.S. on average. In order to present a better picture of the general level of prices (and margins) reached in Baltimore and in the U.S. after the date of final divorcement, average prices (and margins) for the full year 1980 are compared to prices (and margins) which existed in June 1979.

Table 6 indicates that for all eight categories of gasoline sales, increases in net-of-tax retail prices and retail margins in Baltimore were significantly greater than increases in prices and margins in the U.S. generally in the period following divorcement. In June 1979, retail margins for all eight categories of

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[19] Statement before the Subcommittee on Energy, Environment and Safety Issues Affecting Small Business of the Committee on Small Business, House of Representatives, March 31, 1981.

Table 6.

Comparison of Changes in Retail Gasoline Prices (Exc. Taxes) and Retail Margins in Baltimore and in the U.S.

	Leaded Regular		Unleaded Regular		Leaded Premium		Unleaded Premium	
Retail Prices (Exc. Taxes) (cents per gallon)	Self Serve	Full Serve	Self Serve	Full Serve	Self Serve	Full Serve	Self Serve	Full Serve
Baltimore, June 1979	68.46	69.86	73.08	74.33	74.96	75.94	78.26	79.59
Average for 1980	103.55	108.51	108.40	112.61	111.77	114.22	116.61	118.46
Increase in Baltimore Prices	+35.09	+38.65	+35.32	+38.28	+36.81	+38.28	+38.35	+38.87
U.S., June 1979	72.76	74.70	74.87	78.76	78.73	80.52	80.68	82.53
Average for 1980	102.90	107.35	108.15	111.76	112.05	114.66	115.37	118.23
Increase in U.S. Prices	+30.14	+32.66	+33.28	+33.00	+33.32	+34.14	+34.69	+35.70
RELATIVE INCREASE IN RETAIL PRICES (EXC. TAXES) IN BALTIMORE	+4.95	+5.99	+2.04	+5.28	+3.49	+4.14	+3.66	+3.17
Retail Margins (cents per gallon)								
Baltimore, June 1979	10.16	11.51	11.10	12.30	11.49	12.14	11.84	13.16
Average for 1980	9.35	14.46	10.56	14.89	13.37	15.29	13.46	15.52
Change in Baltimore Margins	-0.81	+2.95	-0.54	+2.59	+1.88	+3.15	+1.62	+2.36
U.S., June 1979	12.07	14.10	12.60	14.48	12.96	14.77	12.66	14.58
Average for 1980	8.73	13.15	10.31	13.91	11.93	14.47	12.23	15.02
Change in U.S. Margins	-3.34	-0.95	-2.29	-0.57	-1.03	-0.30	-0.43	+0.44
RELATIVE INCREASE IN RETAIL MARGINS IN BALTIMORE	+2.53	+3.90	+1.75	+3.16	+2.91	+3.45	+2.05	+1.92

Sources: Lundberg Survey data, as reported in Platt's Oil Price Handbook, 1979, pp. 57-58; and National Petroleum News Factbook Issue, Mid-June 1981, p. 94

gasoline sales were lower in Baltimore than in the U.S. generally. Retail margins rose progressively in Baltimore (relative to the U.S.) after the final date of divorcement, and on average for 1980 retail margins for all eight categories of gasoline sales were higher in Baltimore than in the U.S. generally. The relative increase in retail margins in Baltimore after the final date of divorcement was between 1.75¢ and 3.90¢ per gallon.[20]

The results reported in Table 6 are not surprising. Some of the most price competitive sellers in the market were forced out of operation in Maryland by the divorcement bill. While other sellers (chain marketers or jobber-retailers) may fill this low-price niche to some degree as time passes, the consumers in Maryland will still have lost considerable freedom of choice.

The divorcement provisions of S. 326 are an extremely clumsy instrument for addressing the problems of some gasoline dealers in some areas of the country. The bill would deny participation in the retail market to many major refiners who have not increased their participation in refiner-direct sales of gasoline. It would deny these refiners the flexibility to use company-operated stations as vehicles for testing new marketing ideas and new products, as part of training programs for dealers, and as a method of entering new markets or protecting their branded marketing program in declining areas. Most importantly, divorcement would force an important class of competitors out of the gasoline market, reducing the variety and extent of competition and ultimately leading to higher consumer prices.

2. Sale of Stations to Dealers

S. 326 contains provisions which could easily result in the forced sale of stations owned by refiners to the lessee-dealers who occupy those stations. Protection of the interests of dealers is already provided for in the Petroleum Marketing Practices Act, giving them a right of first refusal to purchase stations put up for sale by refiners. But S. 326 goes far beyond this legitimate form of protection by permitting the lessee-dealer to make a counter-offer which, if not accepted by the refiner, would then put the question of the sale price of the station into the hands of an "independent appraisal" system to be set up under regulations to be devised by the Small Business Administration. If the dealer were satisfied with the "independent appraisal" price, the refiner would be forced to sell the station to the dealer at that price.

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[20] These findings are consistent with the testimony of one refiner who indicated that dealers who took over this refiner's stations in Maryland were charging (exclusive of taxes) two to three cents more per gallon than company operated stations across the Potomac River in Virginia in 1980. Testimony of Jess D. Winzenried, Crown Central Petroleum Corp. before the Senate Judiciary Committee, September 25, 1980, transcript p. 60.

This provision raises serious questions of Constitutional law regarding the taking of property. On a simpler level, the provision is both inequitable and illogical.

Assuming the purpose of this provision is to increase the likelihood that the station will remain in operation and not be converted to another use, why should the privilege of buying the station be limited to the present lessee-dealer? Why should other dealers or jobbers or, indeed, any other person with an interest in gasoline retailing not be able to bid? But the whole process of attempting to restrict the future use of the property is a sham in any case. If the property in question has a higher value in another use, the lessee-dealer (or anyone else buying the property under a forced sale) would logically resell it to a third party who was willing to pay the true value of the property in its highest and best use.

Thus this provision of S. 326 amounts to nothing more than a complicated method of transferring wealth from one group in society--the major refiners--to another group--present lessee-dealers. The inequity and injustice of this provision should be clearly evident.

3. Daily Wholesale Transfer Pricing

The most complex economic regulations proposed in S. 326 relate to the requirement that each supplier of gasoline (whether a refiner or a jobber/wholesaler) must maintain on each business day a single "wholesale transfer price" for each type of motor fuel at each "point of transfer" used by the supplier. Ignoring many difficulties in interpretation of the terms used here, this daily wholesale transfer price would be established by the first sale on each day by a supplier to an independent wholesale purchaser. Discounts from this price would have to be justified on the basis of differences in the "cost of manufacture, sale, or delivery of such motor fuel resulting from the differing methods of quantities in which such motor fuel is sold or delivered." Suppliers could make "price reductions offered...in good faith to meet competing price reductions offered by others." Refiners would be permitted to charge "a uniform and reasonable surcharge" for the use of a trademark or a brand name.

These provisions would re-create much of the atmosphere of the recently abolished system of crude oil and gasoline price controls. Like that system, these regulations would require the employment of a large federal bureaucracy and would impose large compliance costs upon refiners and wholesalers. Knowledgeable observers regard the wholesale gasoline market as one of the most complex and diverse markets in the U.S. Literally thousands of "points of transfer" for the wholesale distribution of gasoline would have to be monitored under the provisions of S. 326. Any differential in price at any one of these "points of transfer" would have to be justified by a difficult and expensive analysis of costs, an analysis that would never satisfy all parties. This would lead to endless litigation.

The requirement that wholesale gasoline prices would have to be uniform across wide areas of distribution would make it unprofitable for suppliers to offer local discounts or promotional pricing in an attempt to respond to local competitive pressures. The fact that official prices would be posted each day would make price comparisons among competing suppliers much easier. All of these factors would lead to increased price rigidity and higher prices.

The difficulty of justifying price differentials, the cost of compliance, and the constant threat of litigation would encourage small and independent refiners (who would still be permitted to operate retail outlets under S. 326) to further forward integration into retailing, to the detriment of lessee-dealers.[21]

While refiners would be able to charge a "uniform and reasonable surcharge" to a buyer for the use of brand names and the related services of the brand, it must be expected that many buyers would choose not to pay this surcharge, hoping to obtain a "free ride" on the value of the brand. This would make it much more difficult for refiners to spread the cost of their investments in branded marketing equitably across all users of the brand and thus would discourage the continuation of branded marketing of gasoline.[22]

There is no justification for federal government intervention in the pricing of gasoline, in determining appropriate levels of return to the various participants in the chain of distribution, or in the pricing of trademarks or brand name services. There is abundant and continuing evidence that the gasoline market in the U.S. is competitive. In a free market, each component in the chain of distribution for gasoline must ultimately "pay its own way." Government intervention into the gasoline industry on the scale contemplated by S. 326 would lead to significant new administrative and compliance costs, public and private litigation, price rigidity, and higher consumer prices. The future of branded marketing of gasoline would be threatened. The ability of major brand lessee-dealers to compete in the marketplace would be diminished rather than enhanced.

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[21] H.R. 1362 would impose an additional burden on small and independent refiners of showing that gasoline sold at company-operated stations generated "the same level of profit" (on a netback basis) as gasoline sold to wholesale buyers. This provision would generate additional fruitless litigation.

[22] Particularly in combination with the "open supply" provision, discussed below.

4. Open Supply

The contract between a major refiner and its branded lessee-dealers confers advantages and imposes obligations on both parties. For the lessee-dealers, the advantages are that they are able to take over a business with an already established reputation in the market for a very small capital investment; that they will receive management training and support; and that they will be guaranteed future supply commitments for gasoline. These are advantages which could not be obtained if the dealer were to enter the market by purchase or lease of an unbranded service station.

For the refiner, the advantage of this contract lies in the fact that the dealer will have a greater incentive to maximize the profits of the station, since the dealer's income depends upon his own skill and effort. A dealer (as an independent businessman rather than a salaried employee) is much more likely to understand and become adjusted to the local business conditions. The superior motivation and skill of the dealer, particularly in carrying out the automotive maintenance aspects of the business, make it more likely that the business will succeed than would be the case if the station were operated by salaried employees.

The antitrust laws of the U.S., as interpreted by several Supreme Court decisions, make it illegal as a practical matter for a refiner to require a dealer to obtain all supplies of gasoline and other products from the refiner. Present lessee-dealer contracts expressly permit such outside purchases, providing that the dealer maintains a sufficient supply of each of the refiner's branded motor fuels to meet customer demands. The latter requirement is necessary to protect the investment made by the refiner in branded marketing.

The "open supply" provisions of S. 326 would significantly reduce the obligations of lessee-dealers under their contracts with major brand refiners. It would give them all the advantages of the unbranded service station operators without imposing any of the disadvantages. When the opportunity arose, a dealer could buy gasoline of unknown quality from any seller on the spot market, denying the refiner the market for his product which his investment in the station was intended to ensure. The refiner, on the other hand, would be obliged to stand ready to supply product to the dealer whenever it was in the dealer's interest to request it.

Branded products are preferred to unbranded products for reasons relating to the real and expected qualities of the products carrying those brands. A consumer buying a major brand of gasoline receives both an assurance of the source of the product and a recourse pledging responsibility for performance of the gasoline. A well-known brand is the consumer's guarantee of product quality and accountability. These assurances, together with the other services available at a major brand station (in particular, the acceptance of the credit card), are of sufficient advantage to the consumer to explain the success of branded marketing.

The "open supply" option would undercut the system of branded marketing. Despite the provision for point-of-sale notice to customers regarding outside supplies of gasoline, misbranding and the passing off of inferior grades of gasoline would be an endemic problem. Commingling of various gasolines would be inevitable, and the likelihood that unleaded fuel could be contaminated by mixing with unbranded leaded fuel would be high. Even where the point-of-sale notice provisions of S. 326 were observed by dealers in their sale of gasolines obtained from outside suppliers, an implicit contract between the major brand refiner and the customer driving into the station would be broken in that the customer could not always expect to obtain the desired gasoline product. The question of accountability for the quality of the product sold would not be clearly spelled out. The refiner might easily be forced to accept responsibility for the failure of fuel bought from an unknown supplier. In addition, the fact that the dealer displaying the shield of the major refiner had chosen to reject that refiner's products in preference to another supplier's gasolines would undermine the faith of buyers in the integrity and quality of the brand name. Consumers who prefer to buy a branded gasoline expect to find supplies of the gasoline available in convenient locations throughout the market. Even if a minority of branded dealers were to avail themselves of the "open supply" option, the position of all branded dealers would be eroded.

Major refiners cannot be expected to accept a unilateral abridgement of their contracts with dealers without some reconsideration of the relationship. If branded dealers prove to be an unreliable mechanism for distributing the products of major refiners, the willingness of refiners to continue the flow of expenditures needed to support branded marketing must eventually be reduced. Contracts with dealers will have to carry higher up-front capital requirements, higher rents, or higher franchise fees. Where the refiner's brand does not have sufficient strength in the market, the refiner may be forced to abandon branded marketing. These adjustments will greatly impair the future economic success of the majority of major brand dealers, the very individuals whose interests this legislation was presumably designed to serve.

The contractual relationships between refiners and dealers are entered into in arms-length bargaining and in a competitive atmosphere. Federal government intervention to improve the relative advantages to dealers under these contractual relationships will result in fewer such contracts being agreed to by refiners or in increased costs to dealers to compensate for the changes in the relationship. In the end, the economic position of the dealers will likely be worse.

Like the other provisions of S. 326, "open supply" is based upon the presumption that the major refiners have no commitment to the success of their dealers but, instead, wish to eliminate them from the market. This presumption is both illogical and contrary to the facts, as shown in the history of major brand marketing in this country since the 1920's. As long as freedom of contract is preserved, the demonstrated advantages offered to major refiners by the system of marketing gasoline through independent businesses will ensure that dealers will continue to be a major factor in the gasoline market in this country for the indefinite future.

CONCLUSIONS

S. 326 is unnecessary, largely unworkable, and will be anticompetitive in its effects. The divorcement provisions will eliminate one whole class of competitors from gasoline marketing, many of whom have not expanded their sales of gasoline through company-operated outlets, imposing serious costs in terms of marketing flexibility, and reducing the potential of entry by these sellers into new areas. Divorcement will most likely increase gasoline prices to the consumer.

The provisions regarding sale of stations to dealers are possibly unconstitutional and certainly illogical and inequitable. The only real effect of these provisions would be to transfer wealth from one group in society (the major refiners) to another group (present lessee-dealers).

The "daily wholesale transfer price" provisions of S. 326 will thrust the federal government once again into direct regulation of an industry whose distribution relationships are far too complex for any authority to comprehend. A costly new federal bureaucracy will have to be built up. Compliance costs for the industry will be large. Litigation and the threat of litigation will be all-pervasive. The traditional methods of price haggling and bargaining, which have kept the gasoline market competitive through the years, will give way to a rigid, inflexible system of "posted prices," to the severe detriment of the consumer.

The "open supply" provisions pose a grave threat to the continued viability of the system of branded gasoline marketing in the U.S. Misbranding and the passing off of inferior grades of gasoline will occur; consumers will not always be able to obtain gasolines of the desired quality at their traditional major brand stations reducing their loyalty to those stations. Refiners will be forced to reduce their investments in branded marketing, ultimately leading to the demise of some major brands and the atrophy of others. The dealers representing these major brand refiners will have a clouded economic future.

History should be the first guide to policy. The evidence given by our recent experience with federal regulation of the energy industry in the U.S.

shows that this regulation resulted in serious distortions of the market, energy waste, impairment of national productivity, and the loss of national wealth. To embark again on the path of comprehensive restructuring and regulation of the gasoline industry, as proposed by S. 326, would be a serious error.

PREPARED STATEMENT OF JOHN R. HALLY

I. Introduction

This paper addresses the extent to which the nation's "trade regulation laws"* provide remedies for the problems of the branded gasoline retailer proponents of S.326. In testimony before the House and this Committee, some spokesmen for the bill have asserted, in effect, that those trade regulation laws are useless in addressing the concerns of proponents of the bill. I flatly reject any such contention on the basis of my examination of the legislative record and thirty years of antitrust practice involving litigation for both plaintiffs and defendants, lecturing and counselling.

A summary of the paper's conclusions (discussed in detail below) is that with respect to the three most significant dealer complaints, (1) the nation's existing trade regulation laws do furnish remedies where anti-competitive practices are involved; and (2) where the laws do not furnish remedies for those complaints of the dealers, it is because, for the most part, not anti-competitive practices but the operation of competitive markets are involved.

The principal concerns which the spokesmen for this legislation have voiced, as I have read the record, are the following.

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*A term adopted in preference to "antitrust laws" so as to embrace the Petroleum Marketing Practices Act, 15 U.S.C. §§2801 *et seq*. ("PMPA").

1. The most frequent single complaint is of prices at refiner company stores and jobber retail outlets which are below (or barely above) the retailers' wholesale price. The wholesale transfer pricing (§2(b) of S.326) and, to some extent, the divorcement (§2(a)) provisions are purportedly directed at this complaint.

2. A contention that unreasonable restrictions have been imposed on the branded retailers' access to and right to handle alternative supplies particularly unbranded motor fuel. The so-called "open supply" (§2(c) of S.326) provision of the bill is aimed at this complaint.

3. A basic refrain of an asserted fundamental unfairness in retail competition between independent retailers on the one hand and refiners who are at the same time the retailers' suppliers and landlords. This is purportedly addressed by the divorcement provision of the bill (§2(a)(1)) so far as the sixteen (16) major refiners to which the provision applies.*

Starting first with the open supply issue and then proceeding to the other complaints, I will explore my basic theses outlined above.

II. The Open Supply Question

The open supply provisions of the bill evidence an intent to permit branded dealers (whether refiner or jobber-supplied) to purchase motor fuels from sources alternative to their branded supplier:

> "Notwithstanding any other provision of law, it shall be unlawful for any person to restrain, interfere with, or in any way prevent the purchasing from another, the storing, or the selling of motor fuel by any dealer." (§2(c)(1)(A))

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*It is also addressed by the "refiner sales ratio" provision of the companion House bill, H.1362, §3(b).

This basic prohibition is subject to an exception where a franchise contract provision requires the purchase of motor fuel "exclusively from any refiner or distributor". However, this exception, in turn, is swallowed up by its proviso:

> "... but only if such provision provides that such dealer may purchase such motor fuel from any other person if such motor fuel is not readily available from such refiner or distributor upon terms and conditions reasonably comparable to those available to the dealer from such other person." (Section 2(c)(1)(B))

While the legislative record before this Committee contains scant explication of the intended purposes or effect of Section 2(c), some idea is furnished by the testimony of John J. Flynn on behalf of the proponents on July 30, 1981, before this Committee. That witness submitted that the legislative history of S.326 should reflect that this section is deemed to amend the Petroleum Marketing Practices Act (15 U.S.C., §2802(b)(2)(A) to provide that a dealer's purchase of motor fuel from sources other than his branded refiner, pursuant to the aforesaid Section 2(c) of S.326, shall not constitute a failure to comply with a franchise provision which is "reasonable and of material significance to the franchise relationship", within the language in the PMPA. The effect of any such (implicit) amendment of the indicated subsection of the PMPA would be to prevent refiner termination or non-renewal (assuming compliance with the notice of violation and termination provisions of the PMPA (e.g., 15

U.S.C. §§2802(b)(2)(A)(i) and (ii), and 2804). In other words, under the "open supply provision" as the proponents would desire it to operate, a dealer, furnished with the refiner's pumps, tanks, real estate and the right to use the brand name and credit cards, could nonetheless buy all or a predominant portion of his motor fuel from unbranded (or other brand) sources, pump it through his refiner's equipment,* and the refiner could not exercise the only real power he has to prevent such action, a threat of termination for breach of a "reasonable and material" provision of the franchise and/or underlying lease. Any such development could only result in a substantial diminution of the refiners' incentive to continue to own, improve and lease branded dealer stations; and, in turn, the ability to sustain the very retail sales of branded gasoline upon which the dealers are so heavily dependent would be impacted. Moreover, the consumer's interest in purchasing products identified by the refiner's trade name would be correspondingly eroded. In short, the essence of the franchised retailing relationship--

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*Subject only to the requirement of providing "reasonable notice at the point of sale" (i.e., on the pump) that the motor fuel is not that of the refiner (§2(c)(2) of S.326) whose brand otherwise will appear prominently displayed at or on the approaches to the station.

the franchisor's interest in identifying its product and trade name through dealers devoted to selling that product and promoting that name, and the consumer's interest in dealing with such sources--is rendered virtually meaningless under the "open supply" scheme contemplated by proponents.

On the other hand, to the extent that §2(c) was intended only to provide an opportunity for some measured amount of flexibility on the part of a branded retailer, in such circumstances as supply shortage or the necessity to offer a competitive price unbranded gasoline to meet destructive competition (i.e., the "across the street" situation), the legislation is unnecessary under existing law.

Since the 1949 decision in Standard Oil Co. v. United States, 337 U.S. 293 (1949), holding that full requirements contracts in several western states violated §3 of the Clayton Act (15 U.S.C. §14), it is believed that no refiners, at least major refiners, employ "full requirements", much less "exclusive dealing" language in their franchises.* And, since the advent of longer term franchises and the enactment of the dealer protections contained in the PMPA, the possibility of dealers carrying a measured amount of non-branded gas (subject, always, to appropriate disclosures on the pump) has become a reality even if one not fully welcomed by refiner franchisors.* The dealer, under PMPA, has distinct protection for a merchandising policy whereby, while carrying an unbranded gas in one pump to solve a supply shortgage or excessive price competition situation which his branded supplier does not address, he nevertheless continues to carry sufficient quantities of the refiner's brand name products to preserve the integrity of the refiner's trademark and, as importantly, to meet the demands of consumers who come into the dealer's station expecting to buy those branded products. If the refiner knows of the dealer's split pump operation and, tolerating it, does not assert it as a breach of a reasonable and material provision of the franchise within the 120-day time limit prescribed in the PMPA (15 U.S.C., §2802(b)(2)(A)(i)) he is correspondingly barred from relying on the incident as the basis for termination or non-renewal.** Moreover, while no case presently so holds, one can readily envision a decision under PMPA to the effect that in the illustrative examples noted above, sales at reasonable quantities of unbranded gasoline, with appropriate disclosures, would, in fact, not constitute a breach of the (express or implied) reasonable and material provision of the lease to the effect that the branded dealer must represent his refiner supplier's brand.

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*A typical form calls for the dealer to buy "his requirements of [brand name inserted] motor fuel" from the refiner party.

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*The author knows of at least one major refiner who not only tolerates the practice but provides instructions and a kit of signs which the dealer may use to inform his customers that a particular pump is not dispensing the refiner's gas.

**See, also, Gilderhus v. Amoco Oil Co., 470 F.Supp. 1302, 1305 (D. Minn. 1979) (recognizing "serious waiver and estoppel issues" in granting plaintiff-dealer a preliminary injunction against termination, under PMPA).

In short, the existing law provides reasonable and measured open supply protection to the dealer in situations of exigent need while, at the same time, preserving the legal balance of rights and responsibilities between retailer and refiner with respect to the obligation to satisfy the refiner's interests and the consumers' expectations regarding sale of the brand at a branded station so identified by extensive signs and advertising.

III. The Wholesale Price Underselling Problem.

The single most serious complaint of the dealers to the Congress, including this Committee, has been to the effect that very substantial numbers (not ever quantified, to be sure) of dealers are confronted with the admittedly difficult problem of competitive retail motor fuel prices which are either below or at (or insufficiently above*) the branded dealer's own wholesale cost. The situation of retail prices below the dealer's wholesale cost is said to occur in several competitive situations: (i) at company stores of the dealer's refiner supplier (or of other branded refiners); (ii) at branded retail outlets operated by jobbers, including the dealer's own jobber supplier; and (iii) at unbranded outlets operated by either refiners or jobbers.

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*That is, to permit any margin sufficient to recover operating costs, much less profit, on the part of the retailer.

Clearly the foregoing constitutes "the" problem which supporters of this legislation seek to cure by its enactment. The purported mechanisms of cure are, so far as such underselling occurs in refiner retail operations, the divorcement provisions in the case of the 16 largest refiners, and, so far as such underselling occurs on the part of jobbers, by the wholesale transfer pricing provisions.

Preliminary to a consideration of the extent to which existing trade regulation law addresses this underselling problem, it is relevant to note some of the factual context of the problem which the legislative record has provided. While in the early hearings on S.326 or its predecessors, a frequent refrain was that the underselling problem primarily resulted from refiners' efforts to destroy independent retailers and thereby take over the retailing of motor fuel in the United States, a more balanced position was reflected in the hearing before this Committee on July 31, 1981, wherein jobber operations were identified as the principal source of the problem.* Moreover, the DOE Title III report, while hardly embraced by dealers, nevertheless stands as the most documented report in the record to the effect that the refiners' retail prices during at least the 1972-78 period of the study, were not below most, if not all, costs associated with retailing. Where and as branded refiners operate unbranded outlets in direct competition with their branded dealers, this step certainly is not consistent with any asserted goal of monopolization by them of the distribution of branded gasoline.**

Thus, the most common instances of the underselling problem occur where branded or, even more commonly, unbranded retail outlets operated by jobbers are retailing at prices below branded dealers' wholesale. While such competition is harsh, the rigors of such underselling are partly mitigated by several factors which the record before this Committee has documented. The brand name overcomes some substantial differential. In the early 1960's, a two cent difference between a branded and unbranded gasoline was recognized as a normal spread (Federal Trade Commission Report on Retail Gasoline (1967) 3 CCH Trade Reg. Rptr. ¶10,373, at 18,241). Inflation has swollen the spread which loyal customers will accept to 3 or 4 cents at the present time.*

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*Jack W. Houston (major refiners in recent years have eliminated "abuses", indicating that the jobbers are the major source of this problem); Robert C. Taylor (his Exxon supplier charges 4-4.5 cents over the witness's wholesale cost at competing Exxon stations). Inasmuch as the refiners are, in the majority of instances, the owners or the intermediate lessors of their dealers' premises, it would make questionable economic sense to operate competing company stores at low prices for the purpose or with the effect of destroying the value of such retailer locations.

**The prevention of which was, as noted above, the initial expressed rationale of the legislation.

Secondly, pool margining under which the dealer beats a competitive low price by reducing the price of a popular grade of gasoline, while retaining margin on other grades, a form of loss- or low price-leader retailing, is an available competitive device. Finally, as developed (Part II) above, in connection with the "open supply" question, dealers have the flexibility to obtain and sell (with the requisite disclosure on the pump) reasonable quantities of low price unbranded gasoline to counteract any such price underselling.

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*A leading proponent witness in common response to the questions by the Chairman, described the marginal difference supported by brand as "great" (7/30/81 (Houston)). And, see _Exxon_ v. _Maryland_, 337 U.S. 117 (1978) (unbranded gas typically _sells_ for _2-3_ cents below branded).

However, it cannot be denied that the individual branded retailer encountering retail prices at or below his wholesale price faces a difficult competitive situation. Obviously, such price underselling can result from either of the following possibilities: (a) the refiner or jobber involved is engaged in predatory or discriminatory price selling, or (b) the sheer economics of the particular marketplace permits unbranded motor fuel to be retailed on a self-serve and cash only basis, at prices below dealer wholesale. To the extent that the underselling problem results from predatory or discriminatory pricing, the provisions of S.326 are not necessary (discussed Part 1, below); to the extent they result from the normal operations of competitive markets, the statute should not interfere with such market operations to the detriment of consumers and the competitive process generally (Point 2, below).

1. The predatory and/or discriminatory price hypothesis.

a. Predatory pricing. If particular refiners or jobber entities are currently conducting or in the future should commence, in particular regions, campaigns of predatory pricing for the purpose of achieving local or regional monopolies by driving out branded competition with a view to thereafter increasing price, existing antitrust law provides adequate precedential basis for reaching and interdicting such conduct. If the underselling of gasoline below dealer wholesale is carried out on the part of two or more refiners or jobbers or between one refiner/jobber entity and a subsidiary, a conspiracy to restrain and monopolize trade, in violation of Sherman Act §§1, 2 (15 U.S.C. §§1, 2) can be made out.

> Standard Oil v. Moore, 251 F.2d 188, 204-212 (9th Cir. 1957), cert. den., 356 U.S. 975 (1958)
>
> Malcolm v. Marathon Oil Co., 642 F.2d 845, 848-50 (5th Cir. 1981)
>
> King & King Enterprises v. Champlin Petroleum Co., F.2d ,1981-2 Trade Cases (CCH) ¶64,209 (10th Cir. 1981)
>
> United States v. Yellow Cab Co., 332 U.S. 218 (1947).

Unilateral conduct by a gasoline distributor (refiner or jobber) to monopolize by selling below fully distributed cost can likewise be reached under existing precedent.

> United States v. American Tobacco Co., 221 U.S. 106, 182 (1911);
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> Standard Oil Co. v. U.S., 221 U.S. 1, 43 (1911).

In connection with establishing the possibility of below-total cost selling by refiners or jobbers, the DOE Title III study provides a roadmap to plaintiff's counsel and their economic or accounting witnesses. Thus, if the complainant shows that in particular market areas the refiner is realizing less (i.e., "negative netbacks") on his retail operations than from distributing through (normally higher price) independent distribution, the burden could shift to the respondent to prove the lack of the requisite predatory or monopolistic intent. Wm. Inglis & Sons Baking Co. v. ITT Continental Baking Co., Inc., 652 F.2d 917 (9th Cir. 1981).

Another existing statute, little used to be sure, but the language of which reads directly upon any campaign of retail sales below branded or unbranded wholesale cost is §3 of the Robinson-Patman Act (15 U.S.C., §13a).

> "It shall be unlawful for any person engaged in commerce, in the course of such commerce, to be a party to, or assist in, any transaction of sale, or contract to sell, which discriminates to his knowledge against competitors of the purchaser, in that, any discount, rebate, allowance, or advertising service charge is granted to the purchaser over and above any discount, rebate, allowance, or advertising service charge available at the time of such transaction to said competitors in respect of a sale of goods of like grade, quality, and quantity; to sell, or contract to sell, goods in any part of the United States at prices lower than those exacted by said person elsewhere in the United States for the purpose of destroying competition, or eliminating a competitor in such part of the United States; or, to sell, or contract to sell, goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor.
>
> Any person violating any of the provisions of this section shall, upon conviction thereof, be fined not more than $5,000 or imprisoned not more than one year, or both."

While §3 of the Robinson-Patman Act as aforesaid is not available to private parties (Nashville Milk Co. v. Carnation Co., 355 U.S. 373 (1958)), any egregious conduct in the way of pattern of regional price underselling as suggested in the parade of "horribles" of the proponents could certainly be reached on the part of government prosecutors, in addition to Sections 1 and 2 of the Sherman Act, by this particular statute.

b. Discriminatory pricing. The assertion that discriminatory pricing exists arises most commonly in the context of refiner sales to jobbers at a discount from dealer tank wagon designed to reflect the wholesaling functions (delivery and credit) performed by the latter. That discount is customarily, so the record would show, in the range of 4-4.5 cents.* In particular cases where the jobber is given a discount designed to average the costs of his wholesaling function, especially delivery costs, over all of the retail accounts in his area, the jobber can utilize his full average discount to put gasoline into retail stations established by the jobber close to the refiner's terminal below his wholesale cost to independent dealers or even branded refiner accounts more distantly located.

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*Hearing of 7/31/81 (Houston).

> See: Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 478 F.Supp. 243, 272-276 (E.D. Pa. 1979), aff'd., 637 F.2d 105, 120-122 (3rd Cir. 1981), cert. den. 101 S. Ct. 1981 (1981).

In most instances jobber sales of branded gas at their retail operations, in the circumstances described above, will not involve such a price differential as to be destructive of competing retailer competition and, thereby, warrant litigation. Nevertheless, if a jobber diverts his functional discount into his own retail operations, violation of the Robinson-Patman Act may be made out. From the very beginning of the Robinson-Patman Act, in so-called "dual distribution" situations, the obligation of a seller to insure that a buyer who is entitled to a lower price as to some aspect of his business, but not as to others, is confined in the extent of the allowance to the qualifying portion business has been well established. Thus, the FTC cases* underlying the decision of the Supreme Court in Standard Oil v. FTC, 340 U.S. 231 (1951) (Standard Oil I) the FTC imposed an obligation on the respondent which, in response to a competitive offer, had granted a lower price to jobbers (who served as both wholesalers and retailers), to police the lower price and insure that the customer did not use it in his retail business or extend it to his retail outlets. The Supreme Court's decision did not challenge the order to this effect. In Standard Oil v. Perkins, 396 F.2d 809, 814 (9th Cir. 1968),

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*See, In the Matter of Standard Oil Co., 49 F.T.C. 955-6 (1951) (modified cease and desist order).

rev'd on other grounds, 395 U.S. 642 (1969), it was held that a customer who functions as a retailer and wholesaler is entitled to proportionally equal treatment with respect to his retailer business "but he is not entitled to such allowances with respect to his wholesale business as well". In accord with the *Standard Oil I* line of cases, are such decisions as *FLM Collision Parts, Inc.* v. *Ford Motor Co.*, 543 F.2d 1019 (2d Cir. 1976), *cert. den.* 429 U.S. 1097 (1977). (impliedly assuming that where Ford offered its franchise dealers a lower price on collision parts where resold wholesale and to independent body shops than where the dealer used his parts in his own repair work, that the manufacturer had an obligation to confine the functional price accordingly), and *Bork Auto Parts Machine* v. *Teledyne Industries, Inc.*, 1978-2 Trade Cases (CCH) ¶62,317* (a manufacturer's prohibition of distributors receiving wholesale discounts from using it to compete unfairly with other retailers upheld as reasonable restriction).

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*See: *Palmer News, Inc.* v. *ARA Services, Inc.*, 476 F.Supp. 1176 (D. Kansas 1979). In upholding a complaint against the defendant's conduct whereby blanket discriminatory allowances were, at defendant buyer's behest, attributed by its suppliers to outlets where it was not competitive with plaintiff, the court arguably reflects a view that one may look through a manufacturer's (and buyer's) allocations of allowances to determine those allowances which truly have an adverse effect on competition and, thus, speaks to the same issue as the cases noted above.

The efficacy of the Robinson-Patman Act in covering a number of cases of discriminatory pricing of motor fuels has been challenged on the ground that the Act's requirement that one of the requisite two sales (i.e., at the differential prices) be in interstate commerce means that the Act's remedies are unavailable to dealers who face price underselling from a refinery or jobber located and selling wholly within a single state.* Conversely, however, sales within the boundaries of a single state are not that common and would be even more unlikely in that majority number of states not containing refineries such that the motor fuel involved in a charge of price discrimination would be sold in commerce, thereby invoking the provisions of the Act. *Bargain Car Wash* v. *Standard Oil of Indiana*, 466 F.2d 1163, 1166 (7th Cir. 1972).** Where the alleged price discriminating defendant

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***Littlejohn* v. *Shell Oil*, 483 F.2d 1140 (5th Cir. 1973), *cert. den.* 414 U.S. 1116 (1973); *Roorda* v. *American Oil Co.*, F.Supp. , , 1981-1 Trade Cases (CCH) ¶64,153 (W.D.N.Y. 1981); *Siew Corp.* v. *Royal Petroleum Co.*, F.Supp. , 1981-2 Trade Cases (CCH) ¶62,775 (S.D. Fla. 1979).

**An alternative remedy, applicable in the instance of the situations frequently complained of by dealers in the legislative record of their branded jobbers setting up retail outlets or otherwise selling branded or unbranded gas below the wholesale prices charged the complainant dealer, is the possibility of a claim under the doctrine that every contract (here, the dealer's franchise with the jobber in question) contains an implied covenant not to take action which would defeat the purpose of the contract. *See Photovest Corp.* v. *Fotomat Corp.*, 606 F.2d 704, 727-30 (7th Cir. 1979). *See, also*, Burton, "Breach of Contract and the Common Law Duty to Perform in Good Faith", 94 Harv. L. Rev. 369 (1980).

conducts a genuine interstate selling operation, the relative amounts of the discriminatory (local) and non-discriminatory (interstate) sales are not material to the question of jurisdiction under the Act. Wm. Inglis & Sons v. ITT Continental Baking Co., 652 F.2d 917, 947-9 (9th Cir. 1981).

2. The alternative hypothesis: that unbranded retail prices below dealer wholesale reflect market forces. In testimony before the Congress, proponents of the bill have agreed that not all of the "80,000" dealerships lost between 1972 and 1978 resulted from unfair or illegal refiner or jobber contract and that fundamental economic changes in retail motor fuel distribution were responsible for many of those losses. Certainly, it is not disputed that such underlying economic forces are continuing to pose hazards to the survivability of existing stations of marginal size.* Another economic factor explanatory of the basic complaint discussed in this section of the statement (i.e., unbranded gas retailing below branded dealer wholesale prices) is the fact that, particularly in markets characterized by long or short-term supplies of unbranded gasoline, the latter can be

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*Certainly, among the factors operating to cause dealer closings (apart from any asserted illegality or anti-competitive action by motor fuel suppliers) have been inflationary cost increases, rendering smaller volume stations marginal or uneconomic; reduced consumption from price-induced consumer conservation and increasing car efficiency figures which, in turn, forces still other stations into the marginal category; changes in consumer preference such as self-service and cash only retailing practices; and increasing loss of the repair component of full service station volume to automobile dealers and franchised specialty repair operations.

wholesaled at rack prices plus delivery charges and, in conjunction with the elimination of wholesale markups, advertising and credit card costs associated with branded motor fuel, reach retailers at a wholesale cost several cents, at least, below such branded DTW prices. If such retail outlets were then to employ pool margining and sell such gasoline at acquisition costs, the complained of phenomenom of retail prices below branded dealer wholesale could readily result, all without any predatory or discriminatory pricing activity being involved. It is suggested that in most of the instances where the legislation's proponents assert that existing trade regulation laws cannot reach complained of conduct, they are talking about situations wherein free market factors (such as those just described) are operating.

The proponents of S.326 voice mutually contradictory propositions when they assert in the same breath that S.326 should be enacted because refiners and jobbers are engaging in "predatory" or "illegal" conduct, but that the antitrust laws cannot reach such conduct. With greater logic, one might contend that the very reason S.326 is aimed at refiner or jobber conduct which can't be barred under existing trade regulation laws is just because such conduct represents normal workings of competitive markets and is not illegal or predatory.

3. A brief comment on the problem of the costliness and delay of remedies under existing trade regulation law. Members of the Committee and witnesses have made the point

that even if antitrust remedies are available for some of the dealer complaints, such litigation pursued by private parties is subject to long delays and expense beyond the resources of dealers. No one could deny that all litigation, and antitrust litigation in particular, has become exceedingly time consuming and correspondingly expensive. However, as to the expense aspect, the sheer number of dealer versus refiner (jobber) antitrust cases which have been brought over the years indicates that attorneys willing to take such cases on contingency or reduced fee bases have not been wanting. So far as the delay problem is concerned, developments of the last several years reflect a rising concern of government (bench, bar and legislature) over the delay and the taking of steps to effect some cure of the problem.* In this vein, a study in the writer's office in connection with the preparation of this statement of cases brought under the PMPA, shows an average time from filing to the date of opinion on the dealer's prayer for preliminary injunctive relief averaging only six (6) months.

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*See, Report to the President and the Attorney General of the National Commission for the Review of the Antitrust Laws and Procedures (1979), the recommendations for which are summarized at 5 CCH Trade Reg. Rptr. ¶50,390; The Antitrust Procedural Improvements Act of 1980 (P.L. 96-349) which amended 28 U.S.C. §1927 to increase the penalty for which attorneys may be personally liable to include "excess costs, expenses, and attorneys' fees reasonably incurred because of [attorneys' dilatory] conduct." The bench and bar increasingly are identifying excess and unfounded discovery as a chief villain and prescribing steps against it. See, Kozlowski v. Sears, Roebuck & Co., 71 F.R.D. 594 (1976); American College of Trial Lawyers, Recommendations On Major Issues Affecting Complex Litigation (1981); Fox, "Planning and Conducting a Discovery Program", 7 Litigation 13-17; "The Emerging Deterrence Orientation in the Imposition of Discovery Sanctions", 91 Harv. L. Rev. 1033 (1978).

IV. The "Unequal Bargaining Power" Problem.

Insofar as the theme of unequal bargaining power between refiners and branded dealers has been featured in the legislative record here, it has been primarily in the form of the two major specific complaints discussed above (i.e., the open supply and price underselling issues). To the extent that other aspects of that inherent and unavoidable unequal bargaining power status remain, it is submitted that the same could not possibly justify the unprecedented and anti-competitive aspects of the bill, and, in particular, the divorcement feature. This is particularly so in view of the substantial protections already afforded dealers by Congressional enactment of the Petroleum Marketing Practices Act. Although witnesses before the Committee have deprecated the significance of that legislation, the truth is that the underlying statistics, in this writer's opinion, reflect a substantial success story on the part of the PMPA in eliminating the excesses resulting from unequal bargaining positions. The PMPA became effective on June 19, 1978. Then and thereafter, the average dealer lease or franchise ranged from three to five years.* Thus, in the more than three years since enactment of the PMPA, anywhere from one-half (50,000) to two-thirds (65,000) of the estimated post-1978 totals of over 100,000 dealer lessees would have been subject to renewal. Despite this, the total number of cases which have been decided under the PMPA have amounted to less than 50 or 1/10 of 1% of the total number of potential occasions for dispute. In short, aided by legislation already on the books, all but an insignificant number of occasions for renewal of dealer leases have passed without need of resort to the provisions of the Act or other litigation. In the face of this showing, any contention that the divorcement legislation of the stripe of S.326 is needed to prevent refiners from taking over retail distribution of motor fuel is shown to be rebutted by critical and highly relevant data.

V. Summary.

With respect to the three principal complaints (restriction on "open supply", underselling of dealer wholesale costs and unequal bargaining power) which have been offered to justify the legislation, S.326 is not needed or, alternatively, is not warranted. In the case of the open supply issue, it has been pointed out (Part II, supra) that to the extent the dealers need access to reasonable quantities of or an alternative supply of motor fuel to that from their branded supplier, existing law possess the flexibility to accommodate such development in contrast to the rigidities and unbalancing of the refiner-retailer relationship which proposed §2(c) would create. To the extent a price underselling problem results from either predatory or discriminatory prices, as is sometimes claimed, the Sherman and Robinson-Patman Acts in fact, do supply remedies. However, to the undoubtedly much greater extent that such price underselling results from basic market forces, it is submitted that the bill, including its divorcement feature, is an unwarranted and unwise interference with the operation of such market forces. While, in the case of the refiners affected by the divorcement provision, their company stores are a relatively small portion of their respective total distribution operations, they constitute a vital factor in competition, not with their own dealers, but with other brands and unbranded gas, enabling the preservation of what marketing testimony before this Committee has identified as the "critical mass" of branded outlets necessary for continuance by the refiner of retail operations in a given market. In addition, refiner stores provide important

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*According to an estimate furnished the writer from a Washington, D.C. attorney handling PMPA cases for a major refiner. Even before the enactment of the PMPA, the so-called "TBA Commission arrangement" cases brought by the Federal Trade Commission holding that station leases of ninety (90) days or less than one year rendered dealers so dependent upon refiner-lessor good will that even suggestions concerning station operation had such an inherent coercive power as to constitute a violation of §5 of the Act, had caused major refiners, at least, to lengthen their lease and franchise terms. See, Atlantic Refining Co. v. FTC, 381 U.S. 357 (1965); F.T.C. v. Texaco, Inc., 393 U.S. 223 (1968).

benefits to consumers in such areas as the testing of new marketing techniques which dealers (or jobbers) would have neither the capital nor the motive to undertake. Further, it should be observed that the divorcement proposal, in any circumstances is radically at odds with the all-important trend toward deregulation. In prohibiting a whole segment (refining) of a major industry from engaging in the business of another major segment (distributing) of that industry, the sweeping effect of this legislation is virtually unprecedented. In prohibiting sixteen disparate companies from undertaking any operations whatsoever in the distribution of their own products, the divorcement proposal must be viewed, at best, as anti-competitive, and beyond that, as an unprecedented, unwarranted, Draconian measure. In view of the availability of existing and less restrictive remedies for the problems which this legislation is purported to be addressing, the divorcement proposal should be rejected.

The CHAIRMAN. We will take a recess now until Senator Grassley gets here. He will take over at that time.

He may want to take a further recess for lunch, and he will announce that.

He will be here shortly, and we will take a short recess until then.

[Recess taken.]

Senator GRASSLEY [acting chairman]. The hearing will come to order.

The next witness is William J. Bittles, Jr., Vice President of Retail Sales, Shell Oil Co., Houston, Tex.

I would reiterate what the chairman said—that he would like to keep testimony to 10 minutes.

Your complete statement under committee rules will be printed in the record if that is what you desire.

Mr. BITTLES. That will be fine.

Senator GRASSLEY. Any summarizing you want to do would be appreciated.

STATEMENT OF W. J. BITTLES, JR., VICE PRESIDENT OF RETAIL SALES, SHELL OIL CO., HOUSTON, TEX.

Mr. BITTLES. I would first like to comment on the green button I have on.

Mr. Jack Houston, who is chairman of the governmental affairs part of the SSDA, is in the audience. He presented that to me today.

I do believe in fairness and I do support dealers. I do not support this bill.

However, I wanted to make the explanation so that you would understand what track I am on.

Let me just take a few minutes to tell you how we market gasoline and what our strategy is, because I think it is important to the bill that is being presented.

We have been, for 4 of the last 5 years, the leading marketer in the United States. Our dealers sell more gasoline than any other dealers on the average. They sell more gasoline than independent dealers do on the average.

Ninety-two percent of our gasoline is sold through dealers and jobbers. Eight percent of it is sold into the commercial market to end users or commercial resellers.

More than 60 percent is sold through the dealer organization.

I just want to tell you who these dealers are. These are dealers who primarily lease their facilities from us. In some cases, we own the facility. In other cases, there is a third party that owns the facility. We lease it from them and, in turn, sublease it to the dealer as an independent businessman.

What this does, and I am sure you understand this, is that it creates a very favorable business climate for that individual who would like to go into business on his own.

Today the land that you need to put a service station on—the kind of service stations that we like—can cost anywhere from $200,000 to $400,000.

The facility can cost at least that much again.

The average person, including all of us I am sure, does not have that money to invest himself.

We do that and create this business opportunity for the independent dealer who leases from us.

I do not mean to say in any manner that he does not have a large investment, because he does have a large investment. For a dealer to have $100,000 invested in a service station today is not unusual at all.

A single piece of tuneup equipment that many of our dealers have can cost as much as $30,000, so it is a big thing from their standpoint.

Most of our dealers are very successful business people. Most of our dealers are very professional. They are as professional as anybody on the block in any kind of business.

Whether you look at the bank, the supermarket, the drug store, or whatever the retailer is, most of our dealers are at least as professional, if not more professional, than they are.

Over 50 percent of our dealers have been with us for more than 10 years. That tells you a little bit about the stability of our dealer organization. We certainly don't want to sound like somebody who is trying to get rid of dealers.

The Bureau of Census reports say that there is never less than a 24-percent failure rate of small businesses in the United States.

The Bureau of Census also takes a service station count. They do it every 5 years. The last period was 1972 to 1977.

Over that period, there was a 22.1-percent closure of service stations. That is about 4.5 percent a year.

I do not want to misconstrue that as business failures, because there are dealers who have failed and stations that are still there.

However, there has never been a time that I have analyzed those numbers that the failure rate in our business was not less than small business as a whole in this country.

The vast majority of our dealers really do not want this kind of legislation. They do not want the kind of legislation that could cause us to get out of the branded business and could cause us not to have the interest that we do today in providing the facilities that they run and operate and are so successful at.

At meetings I have had around the country with my dealers and my representatives, and this is just a headcount and I want you to understand that, in talking to some 3,500 dealers, 2,800 of them were not in favor of this bill.

In talking to jobbers, 400 of 420 were not in favor of this bill.

I have letters here to my left that I can leave with you if you like from over 450 dealers and 150 jobbers who are not in support of this bill.

I know you have all heard a lot of horror stories about suppliers and oil companies and how big and bad and that kind of thing. I suggest to you that while some of those are true, and I do not deny that at all—I am sure some of them are true—they are really a very small percentage of the total number of dealers who are in business—a very small percentage.

You can use different numbers today because they count service stations in different ways with stores and so on. However, there are probably about 165,000 dealers in this country today.

The number of horror stories that you hear, and I agree with you that some are probably true, are a very small percentage when you relate it to the total number.

I think most of what you are hearing is because there is less demand in this country than there was.

Gasoline consumption is something like 20 percent less than it was in the peak year of 1978. That is going to certainly cause some failures. The marginal person is going to have a problem when that occurs.

There is no question in my mind that the industry was overbuilt. It was tremendously overbuilt, so there has been a shaking out from that standpoint.

Remember that when there are less stations those that remain sell more gasoline and do more of the other things a service station does.

There obviously are population shifts and urban renewal. We lose maybe 200 to 250 service stations a year which close just because the property has been condemned for road widening and that kind of thing.

Another reason that you hear of failures is this:

Today this business is a very sophisticated business. It takes a very capable guy to manage it—or girl or lady.

The days of mom and pop—that kind of business is gone. Sure you can find them in the country someplace, but the fellow or woman who runs a service station today runs a real big enterprise, and it takes a very capable person and a very professional person to do it properly.

There are some people, obviously, who did not change with the times and that causes some of the failure.

I am proud of these people. They do a very professional job. I am proud of our dealers, and I am proud of the competitive dealers when I see them do a professional job.

I do not like it when I hear people demean them. I do not mean anybody on this committee but sometimes I hear people say just that these poor guys are going broke and could not do anything else and that kind of thing.

Believe me. These are high caliber professional people.

In our business like any other business, there is no guarantee of success. There are going to be failures; there are always going to be failures.

In many cases those that fail, as I said before, just did not keep up with the times or maybe they were in over their heads when they started the business.

Again, the failure rate is relatively low.

Let me just talk quickly about some of the features and my concern about the bill and why would we not be interested or why could we be less interested in promoting the brand and in promoting and building the facilities and providing the business opportunities we do.

The divorcement aspect, I think, is just totally unfair. I think we should have the same right as anybody else to be in business. If we want to run a service station, I think we should have the right to do it.

I do not think we are the problem.

I appreciate there are people that are a problem, and I think there are laws of the land that are already in existence. Those laws should deal with those situations, and I think people should apprise this committee and whoever else is necessary when people are violating those laws.

I see it, and I do not like that either.

As far as rack pricing that controls the price, how can we decide—it is based on each last transaction—and I do not know how we are going to decide that everyday. Either the dealer gets hurt or the jobber gets hurt.

It would be an impossible thing for us to manage.

We cannot allocate costs to each location—our research costs, quality control, and all those kinds of things. It is absolutely impossible.

As far as open supply, there were a lot of questions asked about this. I want to make this point. Why isn't that all right?

Think of it this way. Why would we be interested in building those facilities if we were not going to sell gasoline through them?

Somebody was talking 70/30 percent and 60/40—some of the previous people. If we knew we were going to do that, we are not going to be able to earn the return that the shareholder wants.

If a dealer were buying half from us and half from somebody else, that would not make any economic sense for us to get into the business and build those things.

Besides that, I think there is tremendous confusion. How do you debrand a station?

We took a very small survey at a station where one pump was debranded. Of 40 people—and I appreciate this is small, but we are going to expand this—that bought from that debranded pump, 30 of those 40 thought they were buying Shell.

You just cannot debrand a pump and say that solves the problem. That deceives the motorist. Those 30 people were deceived.

What happens as far as quality and comingling when that happens? Who does the motorist look to to be at fault if he has a problem with that product? How does he know whose it is?

As far as the first refusal aspect, that has been talked about, and I agree. I think there is a constitutional problem there. I think when you take somebody's right away to sell their property for what it is worth constitute a taking without just compensation.

In closing, I do believe there are antitrust laws in effect. If attention is brought to you or whoever as to where those problems are we can solve those problems.

I think PMPA which has only been in effect since June 18, 1978, is showing that can work.

As somebody said today, remember that only one-tenth of 1 percent of the total lease renewals that have come up have been involved with some sort of problem since PMPA was passed. In most cases lease renewals occur routinely.

In closing, I want to say that if I thought—and I have been in this business for 33 years—and every bit of that 33 years has been working with dealers and jobbers.

I am not from the chemical or manufacturing or administrative department or anything else. For 33 years I have worked with dealers and jobbers. If I thought this was a good thing for dealers, I would be for it.

Shell strategy over the years has been to market our gasoline through dealers, and it has not changed. It is not going to change if some kind of legislation does not force us to change it.

If there was benefit here, I would be the first one to stand up and say let's do it. But there is no benefit here. I think it could be very detrimental to the many dealers that are out there today.

I believe the brand and the facilities that we provide and the training and counseling and everything are extremely important.

That concludes what I have to say.

Senator GRASSLEY. Thank you for your testimony. I have some questions that I would like to ask for the record.

Some of them are mine and some of them are from Senator Thurmond.

You state that it would be unfair to ban majors from operating salary stations while permitting small refiners and others to continue to do so. Yet the dealers charge that it is the major refiners who are causing many of their problems.

Under these circumstances, why would it be unfair to address the legislation to the majors?

Mr. BITTLES. I really think that information is inaccurate.

I think maybe there is a major causing the problem, but the major problem the dealer has is not majors that operate salary stations. I am convinced that is not the case that we are the major problem.

I cannot say there are not cases where a major is the problem, because I think there are.

I think the laws that we have should deal with that and that Congress should not try to pass something to impact us and the other people who try to run that business in a legitimate and fair fashion.

Senator GRASSLEY. Do Shell's contracts permit any open supply among their dealers?

Mr. BITTLES. Yes.

Senator GRASSLEY. You do.

Then you have no negative reaction if a dealer engaged in open supply?

Mr. BITTLES. I would have a real negative reaction from the standpoint of the long term.

If a dealer is buying only a part of his demand or needs or requirements from us, if it is a 150,000 gallon station and he buys 75,000 from somebody else, we are not going to get the kind of return we need to maintain that property or to invest in new ones.

The shareholder is not going to sit still for that.

Yes it is fine if he does it. That is great. Most of our dealers do not do it, but let us look at what happens long term. It takes the economic incentive away for us to provide those facilities to provide an opportunity for dealers to be in business.

That is the part that concerns me.

Senator GRASSLEY. Considering your statement that in a normal free market jobber and dealer prices will reach a natural equilibrium, how would you respond to the branded dealers who say they are being forced out of business because the jobbers are able to sell gas for less than the dealer can buy it from the refiners?

Mr. BITTLES. I am sure, again, that there are examples of that. I could not cite them.

I do not think that is a long-term situation either. I think there are jobbers that have done that. I do not think you can really call them jobbers in the true sense of the word. There are people who use that and broker gasoline and so on.

I do not think that is a long-term situation.

I am sure there are, but I could not cite cases where our dealers have been severely impacted by that. However, I am sure there are some.

Senator GRASSLEY. At least you are willing to acknowledge that some people might be forced out of business because of this practice.

Mr. BITTLES. I do not know of any cases where you could absolutely say that was the single reason someone was forced out of business. I do not know of any Shell dealer certainly who was forced out of business because of that.

Senator GRASSLEY. Dealers charge that refiners are selling at retail prices below their wholesale prices to dealers. Do you believe this is occurring? If so, can you explain why?

Mr. BITTLES. We operate 51 salary stations out of the close to 7,000 that we have. We do not do that. I do not think most majors do that.

As I said earlier, there are probably examples of it.

Again, if that is happening, I think that attention should be brought to somebody because that is wrong. I do not agree with that kind of practice.

I think any company the size of a major that uses its economic power to put a dealer out of business by selling their own gasoline for less through a company operation—and you have a dealer they are charging more—that to me is morally wrong, besides being legally wrong.

Senator GRASSLEY. Many of the witnesses have alluded to changing customer preferences and the reason for this seems to be lower prices.

Don't you feel that if the dealer has an opportunity to buy at a competitive price, they then can compete with the company-operated stations?

Mr. BITTLES. Again, I think dealers basically can.

Going back to what I said before, there probably is that exception, and that should be dealt with.

Under normal conditions, certainly a dealer can compete with a company operation.

Let me add this.

We have looked at that thing and studied it for years. The most efficient way to run a service station is through a dealer organization. It is not on a company basis. It is impossible.

When you have a man there who operates that business as his own and the interest that he has because he has his money invested and it is his business and how well he does dictates his lifestyle, he is going to do a lot better job than somebody you are paying a salary to.

Senator GRASSLEY. I have no further questions.

Does Senator Metzenbaum have any questions he wants to ask?

Ms. BAKER. I have just a few on behalf of Senator Metzenbaum.

One question is on this open supply concept.

You say that your dealers are permitted to purchase other suppliers' products.

Mr. BITTLES. That is in their contract.

Ms. BAKER. What confuses me is what all the concern is about pollution of the brand, adulteration of the product and that sort of thing if under current law the dealers can go out now and get nonbranded product?

In other words, you say that the open supply provisions in the bill are going to cause all these problems of comingling and adulteration of the product and pollution of the brand.

Mr. BITTLES. I think that is true.

Ms. BAKER. But if your dealers can do that now, then that is a problem under existing law.

My question is: How do the open supply provisions really change the situation?

Mr. BITTLES. I think so. I think the way the bill is written, and I cannot quote it exactly, but it says that he can buy, if his supplier is not competitive on reasonable terms.

I do not know what that means. Does that mean we extend more credit or less credit? Does it mean there is a price differential? Who is going to examine the quality of what he is buying versus what we are selling him?

I just think it brings forth all kinds of problems.

Ms. BAKER. For a minute, let us forget about the exact provisions of the bill and just talk about the concept of open supply.

Does Shell have objections to the concept of its dealers being permitted to go out and get non-Shell product?

Mr. **Bittles**. Yes.

Ms. **Baker**. What is that objection?

Mr. **Bittles**. The objection is what I said, of course, before.

If we spend $400,000 or $600,000, or whatever it is, to build a facility, we have to get some return on that. Part of that return comes from selling gasoline through that facility.

Ms. **Baker**. You are not locked into your method of calculating the return you are going to get.

If part of your return is calculated based on the volume that is sold and you are selling less volume, then you will adjust that so that you can——

Mr. **Bittles**. If you have made the investment, it is pretty hard to adjust it. You have already made the investment. If he buys half some other place, you are going to earn half of what you earned.

Ms. **Baker**. I am saying to make it profitable to you to enter into a lease with the dealer, you will make adjustments in terms of your contractual relationships with the dealer to deal with the fact that he is pumping less of your product.

That does not seem to be an unsolvable problem is what I am saying.

Mr. **Bittles**. I am not sure I understand what you have said really.

Ms. **Baker**. If that particular dealer is selling less Shell product and therefore that station, if you calculate it on a volume basis making less money for you, then you would, if you wanted to keep that station in business and you thought it were beneficial, adjust your contractual relationships with the dealer to take into account the fact that he is not pumping as much Shell gas.

I am saying that you are not locked into it, but the contractual relationship——

Mr. **Bittles**. Let us talk about delivery, for example.

We deliver to most of our dealers depending on the State laws and so on of somewhere around 10,000 to 12,000 gallons at a time.

Let us say that the way that bill is written he decides he wants to buy—and these are extremes, obviously—100 gallons at a time.

If we had to deliver to dealers at 100 gallons at a time, we would have to charge considerably more than it is today.

The efficiencies that we have built into this system go away because volume is a big part of efficiency. If you reduce that volume, obviously we are less efficient and earn less.

Ms. **Baker**. As you suggested, the dealers are very, very smart and bright business people. They understand that concept too.

There is a certain market out there for branded product, I think you would agree, and probably a certain market out there for nonbranded product.

The question is: Why not let the market make those decisions? Why should Shell be making the decision that this dealer should take——

Mr. **Bittles**. I do not think Shell is making the decision. I think there are many, many independent stations. If a customer wants to buy from an independent he can do that. We do not have to have independent gasoline in the Shell station to accommodate the motorist.

Those independent stations are on most corners in every city. If he wants to buy independent gasoline, he can go there. We are not making the decision for the motorist.

Ms. BAKER. You are precluding your branded dealer—although you say you are not precluding.

You say he could buy branded product, but it sounds as though you are not going to be really happy if he does.

Mr. BITTLES. If you were the owner of that station and you spent that money and expected to get some kind of return, besides being able to pay the mortgage and the taxes and interest and those kinds of things and somebody decided they were going to pay you half of what you had agreed to, you would not continue making those kinds of investments because they would not be profitable for you. That is the point.

Ms. BAKER. Then the dealer would make a judgment about whether it is in his or her interest to contract on that basis. The two of you, presumably, would reach a meeting of the minds based on the reasonable amount of Shell product it made sense for him to carry versus whether it was reasonable for you to have that station to carry that Shell product.

The contracting process and the free market process would——

Mr. BITTLES. Let me come back to what I said earlier too.

How does the motorist know what he is buying?

People who drive into Shell stations expect to buy Shell gasoline.

Ms. BAKER. Other companies do it. I think it is not unheard of. There is a concept in current law——

Mr. BITTLES. I would say it is done in a very, very small percentage of the total sales that go on. It is a very limited kind of thing.

Ms. BAKER. Let me ask just one other question based on some of the data that you provided.

One of the charts that you submitted purports to show that consumers will be hurt by divorcement and does this by looking at prices in Baltimore compared to other comparable eastern seaboard cities.

I was confused by the data when I took a look at it because you suggest that the reason in past data analyses that the prices in Baltimore seemed to be lower than prices in the other east coast cities is because taxes were lower in Baltimore.

Mr. BITTLES. Right.

Ms. BAKER. Your chart shows tax adjusted figures.

Using just those tax-adjusted figures that you provide, when I look at the data, the Baltimore price is lower than the price in three of the four cities in virtually every single month from June 1980 to April 1981. I do not understand that.

Mr. BITTLES. I have with me the information on that. It was published on the 16th of this month, and it would not indicate that.

In those comparable cities, the price is approximately the same.

The retail price is lower, and that was talked about earlier. The dealer margin has shrunk.

If you say this bill is going to shrink dealer margins by eliminating salary stations that does not make any sense. If that is the point people are trying to make, I am not for reducing dealer margins. Dealers have enough problems right now with margins.

For somebody to try to relate the absence of salary stations causing dealer margins to be lower, if it did that and it does not do that, but let us say it did because that is the way it has come across, that is a very bad thing for dealers. Dealers have enough problems right now with margins.

Ms. **Baker**. Just getting back to the numbers, when I look at the numbers, from June of 1980 through April of 1981, the numbers are lower in four out of the five cities.

All I am saying is that if your chart purports to show that prices are higher in Baltimore, it does not seem to do that.

Mr. **Bittles**. I do not think we said they were higher. I think what we showed is that the wholesale price in Baltimore has not changed relative to the other cities it was compared to.

In fact, divorcement has done nothing.

The Baltimore thing is only divorcement; it is not open supply and rack pricing and that kind of thing—and it includes all refiners.

What I am saying to you is that divorcement has had no impact on the prices in Baltimore. We have not done anything different in Baltimore than we did when there were salary stations there or there were not.

Ms. **Baker**. The people who are suggesting that if we enact this divorcement legislation that prices are going to go up to the consumer are not correct either; right?

Mr. **Bittles**. I do not believe that at all. I think a dealer can operate a station, as I said before, more efficiently than anybody can run one on salary.

If he can do that, and I believe he can, it does not stand that prices are going to go up.

Ms. **Baker**. Thank you.

Senator **Grassley**. Thank you very much for your testimony.

We do not have any more questions for you. Your testimony contributed greatly to our understanding of this legislation.

We would invite you, if you have anything more for consideration of the bill, to submit it in writing.

Thank you very much.

Mr. **Bittles**. Thank you.

[Material follows:]

PREPARED STATEMENT OF W. J. BITTLES, JR.

Shell's Logic For Opposing The Legislation

I am Bill Bittles, Vice President of Retail Sales for Shell Oil Company. It is a pleasure to be here today to discuss S 326 and outline its implications for Shell and the petroleum marketing business. The proponents of S 326 often refer to it as a bill designed primarily to prevent major oil companies from operating service stations on a salary basis. -- And if that were truly the case, it would be of little direct consequence to Shell since nationwide, we have only about 51 salaried stations which would be affected. However, that is not the case -- the bill in question contains other provisions commonly referred to as "rack pricing," "open supply" and "first refusal" which could negatively impact Shell's business -- The business of our dealers and jobbers -- And the product quality, convenience and service provided consumers through the sale of Shell branded gasoline. If S 326 passes, as written, our ability to continue the long term marketing of branded Shell gasolines in the U. S. could be significantly impaired. We will demonstrate why and how and the adverse impact this will have on consumers by answering the following questions:

- What does branded marketing of gasoline do for consumers? -- And ---
- How will "rack pricing," "open supply," "first refusal" and "divorcement" demotivate branded gasoline marketers.

First let's talk about what branded marketing does for the consumers.

Over the years, the characteristics of American consumers have undergone marked changes -- in taste, in preference, in style. But one characteristic of these consumers has not changed: their desire to know just what they're buying and who stands behind it.

This applies to everything from automobiles to bicycles, from clothing to chicken soup. And it applies to gasoline. People like to know what kind of gasoline they're putting in their tanks, and branded gasoline refiners try to see that they do. Indeed, brand name refiners, dealers and jobbers have adopted a wide range of manufacturing and marketing strategies in their ongoing competitive struggle for the affections of the buying public. And while these strategies have resulted in successes and failures of various shades, one unqualified success has been the evolution of a better product and service for the gasoline buyer. The healthful competition and product responsibility inherent in branded gasoline marketing have yielded real advances in refining and marketing techniques and, if left alone, will no doubt yield further advances and consumer benefits.

Imagine a marketplace where similar products had no brand identity and there was no way to determine source or origin. If, for example, all the labels on canned chicken soup were removed, there would be absolutely no way for the customer to tell one from another. Cans of Campbell's, Swanson's and the grocery store's "house-brand" would be indistinguishable. As a result, the national brand leaders would have no motivation to maintain consistency or improve taste, quality and nutritional value. Private brands would have no motivation to try to convince people they offer equal quality at a lower price. No one would try to come up with a better chicken soup, since it would be impossible to let people know the latest version was "new and improved."

Likewise, there are specific benefits to branded gasoline marketing, benefits that touch the consumer in a number of different ways. They include:

* Product Quality: Geographic climatizing, additive packages, startability, product purity, drivability and anti-knock characteristics all receive careful attention, since branded gasoline is normally manufactured to more exacting quality specifications than unbranded gasolines.

* Convenience, Service: Dealer training, credit cards, mechanical services such as Shell's Auto Care program, station site selection and even attention to restrooms are all part of the overall brand package and image. Dealers make their own decisions with regard to the conduct of their business, but branded marketers like Shell, devote considerable money and manpower to helping dealers provide the consumer the proper mix of these convenient

services. Shell's Auto Care program, which now includes participation by about 2,000 branded Shell dealers, is a typical example of a sincere effort on the part of a branded gasoline marketer to improve and enhance the mechanical services available to customers. The program requires that a certified mechanic be employed at all stations displaying the Auto Care logo and that the station be properly equipped to handle tune-ups, brake work, front-end alignments, and air conditioning service, along with other more universal station activities. Auto Care dealers give customers written estimates, guarantees and the return of old worn out parts. Shell went into the Auto Care program in response to market demand and it is an example of a consumer benefit which might be threatened if S 326 passes.

* Complaint handling: Brand marketers have a definite vested interest in seeing that customers are satisfied with their product. If insulated from consumers by an unassociated chain of unbranded stations, refiners would have little, if any, incentive to see that buyers are satisfied.

* Continuity of supply: Although there are no absolute supply guarantees, an oil company with a financial commitment to a network of branded service stations has a stronger incentive to maintain continuity of supply to those stations during periods of shortage.

* Efficiency of supply: A financial stake in service stations motivates an oil company to achieve economies of scale, improved distribution and other efficiencies which benefit consumers.

Congress wouldn't legislate that the label be removed from every can of chicken soup. Why then should it enact legislation which threatens branded marketing in the gasoline business? We know that most Shell dealers and jobbers would be very unhappy if legislation encouraged us to give up our brand. I know that some dealers support this legislation but I do not believe they represent all dealers and jobbers. We have made an effort to explain this bill to our dealers and jobbers and we have encouraged them to write to you and other members of Congress about its impact. We have copies of over 450 letters, mailgrams, and similar communications from dealers and over 150 from jobbers indicating nonsupport or serious concern with S 326 and/or the very similar House Bill, HR 1362. In addition my personal representatives and I have met with over 3,500 Shell dealers and found that approximately 2,800 oppose S 326 and over 420 Shell jobbers and found that approximately 400 oppose S 326 in all parts of this country. I judge that 75% of Shell's branded independent dealers and jobbers do not support S 326 and they are in good company. Others who have made public statements opposing this legislation or who testified this year against the House Version, HR 1362, include the U.S. Chamber of Commerce, the Department of Justice, the Department of Energy, the Federal Trade Commission (Bureau of Competition), the Society of Independent Gasoline Marketers of America, the National Oil Jobbers Council, the Independent Refiners Association of America and the American Petroleum Institute. We judge that, although the representatives of the SSDA, who support this legislation are sincere, that they have a very narrow base of support within industry. The consumer now has a choice between branded and unbranded gasoline. We can't see how reducing the incentive to be a branded marketer would be in the public interest.

Having addressed the benefits of branded marketing, let's take a look at how "rack pricing," "open supply" and "first refusal" will result in deterioration of branded gasoline selling.

First, rack pricing.

The "rack pricing" provision would limit the selling of petroleum products to different classes of customers at different prices. While this may seem reasonable at first glance, such proposals fail to recognize that most major refiners are primarily wholesalers and different classes of customers receive different prices which reflect the competitive structure in the marketplace.

Jobbers, for example, have usually developed retail areas in a manner similar to modern franchises; they almost always have their own bulk storage plants, trucks and employees. Dealers, who are served directly by refiners, on the other hand, usually operate individual stations. Historically, a jobber paid less for product because of competitive conditions and because what he did was worth more. Given a normal free market, jobber and dealer prices will reach a natural equilibrium which recognizes the economic worth of the services each performs. Unnecessary legislative interference will inhibit that natural process and will serve no useful purpose.

The legislation is difficult to interpret and it has some exceptions but it could be construed to cause Shell to sell at the dealer price at some terminals with jobbers paying dealer price less certain strictly cost justified deductions. Jobbers could have little incentive to continue as our customers under this type of regulation. On June 9th, 1980, I testified before the Senate Energy and Natural Resources Committee and appealed for the elimination of price and allocation regulations because they discriminated against dealers and in favor of jobbers. I am now appealing to this group not to pass S 326 because it may severely penalize jobbers. Attachment 1 is a resolution from our Jobber Council (a group elected by their fellow jobbers) opposing this legislation.

In addition, refiner costs related to the brand for things like marketing, research and quality control are now averaged into product prices. If we are forced to identify and separate these costs at each delivery point for each potential type of buyer full recovery may not be feasible. This constitutes a disincentive for continuing a service station network or, for that matter, branded marketing.

Second, Open Supply.

While existing law generally grants dealers the right to sell anyone's gasoline they choose, some dealers would like the right to sell other refiner's products in a manner which would severely impair the value of a brand or trademark. Thus, although Shell does not require dealers to purchase product solely from Shell, "open supply" raises a number of issues:

o A motorist pulling into a Shell station expects to purchase Shell gasoline, with the product and performance characteristics and consistency associated with our brand. None of this could be assured under an "open supply" situation as prescribed in S 326.

- We will experience additional costs to protect our trademark rights under the federal Lanham Act and various state laws. The consumer will ultimately bear those costs.

- The consumer has the right to be protected from deception, mistake or confusion, but with "open supply" as proposed in S 326 there would be an increased chance of product adulteration or co-mingling.

- In the event of a product quality problem the consumer would have difficulty identifying the culpable manufacturer.

- Increased variations from environmental standards could take place. If lead is found in unleaded gasoline, responsibility could be difficult and perhaps impossible to ascertain.

- Oil company incentive to invest in maintenance of existing stations, or to build new ones, could be destroyed if widespread unbranding took place.

Third, "First Refusal."

Through the years, refiner-marketers such as Shell have invested billions of dollars developing a network of service stations. A variety of ownership and leasing arrangements are in force. Shell owns, both land and buildings, at less than one-fourth of the approximately 15,400 branded locations.

When a refiner-marketer decides to sell the station premises, the dealer already has rights to purchase it under reasonable circumstances as provided in the Petroleum Marketing Practices Act.

Some dealer organizations are asking for what appears to be added legislated purchase rights in every case in which a refiner-marketer elects to sell the station premises. Such rights could even cause the sale to be at a price below market value. The bill provides that if Shell gets a bonafide offer from a third party then that offer must be submitted to the dealer. If the dealer doesn't like it he can submit a counter offer and if no agreement is reached, he can cause an appraisal to be made to determine the price at which the property is to be sold. Normal real estate practice indicates that a bonafide offer to purchase should fix the value of the property. We think there are grave constitutional problems when one is required to sell his property at less than true value because this would constitute a taking without just compensation. The bill also requires the S.B.A. to become involved in regulations dealing with the appraisals which is an example of another unnecessary regulatory undertaking.

Shell is opposed to any encumberance on our properties. How many homeowners would be willing to encumber their home with a first refusal (with prescribed rules on how it would be valued and purchased) to a neighbor? -- And what about those prescribed rules in the bill. Are they clear and definite? We don't think so. Two examples follow: (1) How much time, for example, does a dealer have before he must put up his money and close a sale after receiving an appraisal? (2) Some people have suggested that the "first refusal" extended to situations where Shell leases the property from private property owners. Should the rights of these property owners be considered?

Serious Constitutional issues may also be involved in the encumbering of a particular class of private property.

Dealer "right of first refusal" could: perpetuate the existing distribution system, denying conversion of investments to facilities tailored to today's needs; remove refiner-marketer incentive for further service station land purchases; and if the House Version, HR 1362 was adopted, ultimately transfer as much as 3 to 6 billion dollars now invested by oil companies to the government, via SBA mortgages -- Ask yourselves! Does the government want to finance the purchase of major oil company owned service stations?

Gasoline is now free from allocation controls, with no artificial barriers to entry into the service station business. Dealers, jobbers or investors are free to build stations and arrange supply agreements. Changes in the law regarding the right of first refusal are simply not needed and they will discourage station development and branded marketing.

Lastly -- what about the portion of the bill that deals with the elimination of major refiners operated salary stations. Shell could certainly deal with the approximately 51 units we have in that operating mode without financial hardship. However, we oppose this portion of S 326 because:

- It's anti-competitive and unnecessary. Normal competition in a decontrolled market should be allowed to distinguish the efficient from the inefficient -- be they dealers, jobbers, distributors, chain merchandisers or salary operated stations.

- It's anti-consumer, removing a significant form of competition from the marketplace.

- Salary stations are used to test new concepts, new equipment and new products. They are also used for training. Without them, productivity will be reduced and our branded effort damaged.

- Dealers enjoy considerable protection under P.M.P.A.; there is no need for additional legislation against salary stations.

- DOE's Title III report (submitted to Congress January, 1981) finds:

  1) No "massive movement by refiners into the direct retailing of gasoline;" and

2) No evidence "that refiners are subsidizing the sale of gasoline at retail as part of a predatory campaign..."

Our primary concern in this area, however, is for the dealers and jobbers who operate those approximately 15,400 Shell stations. We are concerned with equity for all. The proposed divorcement legislation would ban majors from operating salary stations while permitting small refiners, chain merchandisers, jobbers and others to continue. We do not think that it would be in our dealers interest to have major brand salaried stations banned, while not banning those run by independent and small refiners, mass merchandisers, jobbers and distributors, because in many cases it's the salaried outlets of such others which are competing with them. Different rules for different teams would be like making one team play with ten men against another with eleven in the Super Bowl.

Shell's Counter Arguments to Statements in Support of The Legislation

I have personally had the opportunity to be at the hearings held in the House on HR 1362 and at the previous Senate hearings on S 326. I have heard things said which are simply not true and I feel compelled to deal with some of these issues.

(1) First - Shell has no motivation to destroy our service station dealer network -- as a matter of fact Shell relies almost exclusively on small business persons, branded dealers and jobbers, to sell our gasolines. In 1980 92% of our total gasoline sales were made through those two classes of trade and just over 1% was sold at our salary operated stations. The health and viability of those customers is essential to our marketing effort. A great deal of our brand value is wrapped up in the long standing relationships we have developed with dealers and jobbers and an intentional effort to destroy those relationships would be contrary to our economic interests and socially unwise. We are concerned that the proposed legislation, particularly the elements referred to as "rack pricing," "open supply" and "first refusal" because they would discourage our branded selling efforts and jeopardize our

long term relationships with those branded customers. We are particularly concerned for the future of our jobbers and the roughly 8,000 dealers they serve who may be disadvantaged competitively if S 326 passes. We are also worried about the possibility that the "rack pricing" section of the legislation might induce some jobbers to abandon existing dealers and other customers and convert to 100% salary operation. --- Yes, we are concerned and as demonstrated most of our branded dealers and jobbers are also concerned about this legislation.

Some people contend that major refiners have economic power emanating from low domestic crude costs combined with the legal ability and the motivation to drive dealers and jobbers out of business and take over all stations and run them on salary. Let's examine these premises:

1) Crude oil replacement costs are reflected in market prices over the long term. To sell below market price for any extended period of time forecloses a refiner's opportunity to replace that crude and thereby perpetuate his long term business.

2) The Sherman, Clayton, (as amended by Robinson-Patman) and FTC Acts protect dealers and others against anti-competitive pricing practices and prevent refiners from engaging in predatory practices. Witnesses representing the D.O.J., F.T.C. and D.O.E. have all testified in opposition to this bill (or its House companion HR 1362).

3) PMPA protects branded dealers and jobbers against arbitrary terminations or non-renewals.

4) For many refiners, like Shell, dealers and jobbers are essential to their long term marketing strategy.

For these reasons Shell has no plans to destroy our station network which is effectively being run by dealers and jobbers. We have no desire to operate all those stations on salary. Our observations in the marketplace tend to confirm the D.O.E. statistics which indicate that only 5% of the 1979 gasoline volume sold by Shell, Exxon, Amoco, Texaco, Gulf, Mobil, Arco and Chevron moved through salary operations. In 1972 those same refiners moved 4% of their volume through salary stations. One of the earlier witnesses attempted to discredit the D.O.E.'s two-year Title III study, even though he stated in his testimony that it was "bulky", that he had it only a "short time", and that his analysis was "preliminary". He asked you Senators to accept in its stead a study by the Canadian Restrictive Trade Practices Commission supporting divorcement. I fail to understand his logic. The D.O.E. study is current and it covers the U.S. markets. The Canadian study deals primarily with Canada. Those who suggest that the largest refiners have "run off" the dealers and jobbers to convert to salary operation are simply ignoring the facts and using whatever they can dig up to support their predetermined views.

(2) Second - Members of the Senate will remember that the Petroleum Marketers Practices Act (PMPA) was passed in 1978 and was designed to protect branded dealers and jobbers. Many of the unpleasant stories that are still being referred to were dealt with in great depth by the Congress in the mid 70's and were the subject of exhaustive testimony. PMPA specifically requires that termination or non-renewal of a branded dealer or jobber be accompanied by a reason set forth in the act. PMPA also deals with proper notice, and other significant matters which govern the relationship between a refiner and customer. Refiners are also specifically prohibited from terminating or not renewing a dealer on business grounds, for the purpose of converting to salary station operation. PMPA also grants dealers "first refusal" rights but as written those rights do not normally result in brokering of the property which may result if we are forced to sell to dealers at less than market value.

The act contains liberal provisions for private enforcement actions. A franchisee may bring an enforcement action in the appropriate federal district court without having to satisfy the usual amount-in-controversy requirement. In addition to his actual damages, a franchisee may recover exemplary damages for willful violations, and he may also recover his attorney and expert witness fees.

Further, the court is empowered to provide whatever equitable relief it deems necessary, including continuation of the franchise relationship. In an important departure from the standards normally governing the issuance of an injunction in federal court, the court may grant the franchisee a preliminary injunction if the court is satisfied that there is a fair ground for litigation and that the balance of the hardships favors the plaintiff (dealer) (Section 105 (b)(2). Ordinarily, a plaintiff must establish a probability that he will prevail on the merits and that he will suffer irreparable injury in the absence of an injunction. Thus, in both respects, the act imposes a lesser burden on the franchisee seeking a preliminary injunction than a plaintiff would usually confront.

Another provision strongly favoring the franchisee is that regarding burden of proof. Section 105(c) provides that, while the franchisee has the burden of proving that the franchise agreement was in fact terminated or not renewed, the franchisor must establish as an affirmative defense that this termination or nonrenewal was properly based on some provision of the PMPA and that the franchisee was provided proper and timely notice.

Some court decisons have already been reached under the PMPA. In general, these cases have held for the franchisee when the franchisor's action was not sufficient under the Act to adequately protect the rights of the franchisees.

A number of cases seem to indicate that the overall fairness of the franchisor toward its franchisees will be an important judicial consideration. Marini v. Atlantic Richfield Co. was a motion for a preliminary injunction under Section 105(b2). The court found that Marini's arrearages had arisen from company pressure to purchase a large amount of motor oil that he could not sell in volume. His inability to sell it allegedly resulted from his supplier's having placed it in four nearby stores in violation of an exclusivity promise it had made to Marini. The company then cited the arrearages as grounds for termination. Since the court found that the company had by its action exacerbated the arrearages, the company had no right to attribute those arrearages to Marini and thus no legal right to terminate his franchise.

Courts have also been concerned to protect franchisees against violation of the notification requirements, whether or not they suspect that a defect in notice was a means to mask an improper motivation for termination or nonrenewal. In *Wojciechoswki v. Amoco Oil Co.*, the franchisee sought to enjoin nonrenewal of a trial franchise. The court found that, in failing to give proper notice of nonrenewal, Amoco had violated Section 104(c)(3)(A) of the PMPA. The court thus permitted the injunction to issue, even though provision of the proper notice would have permitted nonrenewal.

These are just two recent examples to demonstrate that dealers and jobbers can win in court when they should. Our records show that there have been 18 P.M.P.A. cases reported (published) with decisions that favor dealers over suppliers since the law was enacted in 1978. We hope these facts will mitigate against contrary testimony you have heard.

The Department of Justice has maintained continuously that there are sufficient laws in place to protect dealers. PMPA is a law which has been given almost no chance to operate because it's relatively new and many of its provisions were preempted by controls. Congress should not be impressed by anti-refiner arguments which pre-date PMPA. Congress should, however, observe what actually happens in a decontrolled market in which PMPA's provisions will be fully operative.

It is a rare and dangerous exercise to meddle in the basic structure of the marketplace and to place controls on certain segments of the business while permitting others to go free will inevitably result in inequities and a plethora of litigation. As major refiners struggle to adjust their pricing system to comply with S 326 the ultimate losers may be consumers and certain small businessmen. Left alone some refiners may elect to sell using some form of "rack pricing" suitable to the customers they serve, some may offer an unbranded form of "open supply" and some may sell their stations to dealers and jobbers. Others who have differing marketing efficiencies may employ different sales tactics to compete.

(3) Third - Those who contend that S 326 will lower consumer prices and work effectively because it's similar to the divestiture law in the state of

Maryland are ignoring the facts. There have been divorcement laws considered in a number of states. However, no state has passed a law with provisions like those found in S 326. The Maryland law is very different from S 326. It contains no provisions for "open supply," "rack pricing" and "first refusal" that are similar to those found in S 326 and the state law prohibits all refiners and producers from operating salary stations; not just certain large refiners. In addition, we do not believe that either the retail or wholesale gasoline prices in Maryland have gone down as a result of the passage of a divorcement law. The retail prices in Baltimore, MD are almost always lower than in Atlanta, GA, Norfolk, VA, Washington, D.C., and Philadelphia, PA, primarily because the combined state and sales tax are lower in Baltimore. In Atlanta, for example, the total tax on gasoline is currently (16.6 cpg September, 1981). In Baltimore it's 13.0 cpg or 3.6 cpg less. (See Attachment 2.) During the period from June 1980 through September 1981 the lower retail prices in Baltimore, as reported by Lundberg, appear to be the result not of divorcement but because of lower taxes. (See Attachments 2A and 2B).

The ex tax independent (rack) wholesale gasoline price, as reported most recently by Lundberg on 10/9/81, reflects a higher price in Baltimore than in Atlanta, Norfolk and Philadelphia on both regular leaded and regular unleaded gasolines. The average major D.T.W. price on that date for leaded regular gasoline was higher in Baltimore than Atlanta or Washington according to Lundberg. (See Attachment 2C). I suppose that I could try to persuade you that the higher wholesale prices in Baltimore are the result of the states divorcement law but my judgement and experience tells me it probably isn't that simple. Both retail and wholesale prices are a function many variables and a wide range of makret conditions.

Some people have also contended that the rate of closure of service stations in Maryland has been slowed relative to other states, since provisions of this divorcement law went into effect in 1978. Station closure rates in Maryland may be slower than elsewhere but we don't believe that their divorcement law is responsible. The Bureau of Census counts service stations every five years. Their most recent counts were made in 1972 and 1977 prior to the implementation of divorcement in Maryland. We will probably have to wait for the 1982 census to know exactly what's happening everywhere. However, it is interesting to note that between 1972 and 1977, the station closure rates in both Maryland (-18.2%) and Virginia (-14.8%) were slower than the U.S. average of -21.1% (NPN Fact Book 1980). A continuation of the historic norm would therefore not be surprising and would not be attributable to the divorcement law. Station closure rates are a function of many things including population shifts, income, road changes, zoning laws, vehicle registrations, rapid transit developments, etc. In addition, we should understand that all businesses, large and small have failure rates. Dun and Bradstreet publishes monthly statistics on business failure rate per 10,000 listed concerns. Over the last 10 years, the annual failure rate of all businesses surveyed has never been lower than 24 percent. In 1980 it was 41 percent and in a letter issued May 7th, Dun and Bradstreet's National Director of Training and Development indicated that the failure rate in the first quarter of 1981 was substantially above the same period in 1980. It is fair to conclude from this analysis that modern businesses fail at annual rates of from 25 percent to 45 percent.

According to the Bureau of Census (Source: 1980 NPN Fact Book), the service station population declined by 22.1 percent between 1972 and 1977 which represents a station closure rate of under 4-1/2 percent per year. Although station closure rate and business failure rates are not identical, the 4-1/2 percent per year closure rate number is certainly not remarkably high, particularly for an industry that even most dealers agree was overbuilt.

Conclusion

In a competitive marketplace some business successes and some failures are inevitable and the losers will always be looking for protective special interest legislation. HOWEVER, THE BASIC PRINCIPLE OF ANTITRUST LAW WHICH CONTEMPLATES THE PROTECTION OF COMPETITION, NOT INDIVIDUAL COMPETITORS, MUST BE ADHERED TO IF CONSUMER INTERESTS ARE TO BE SERVED AND HIGH PRODUCTIVITY PERPETUATED. Station closings reflect changing marketing conditions, population shifts, urban renewal, road changes, and consumer preference for high speed, cost-efficient self-service operations. They do not reflect any massive movement by Shell or industry into refiner operated salary programs as is clearly shown in the DOE's Title III Report. After many years of controls and the inequities they created for many dealers, a free market situation has been recently reestablished in our industry. If the experience of DOE regulation has demonstrated anything, it is that the freeze of market relationships can be only temporarily successful in the best circumstances, and skews the allocation of resources away from higher valued uses. Every state legislator who is now wrestling with the problem of coming up with new congressional districts, to give proper representation in Congress, will understand the extent of change that has taken place. These are the same kinds of changes that impact gasoline marketing. Before considering new legislation, Congress should give the marketplace a chance to adjust.

I appreciate the opportunity to express Shell's views and hope that this testimony has contributed to improved understanding of the serious problems that could evolve should S 326 pass.

ATTACHMENT 1

RESOLUTION BY SHELL
JOBBER COUNCIL

Dear Shell Jobber:

The following motions were unanimously agreed upon by undersigned attending members of the Shell Jobber Council at a meeting held on 17 March 81, at the Hyatt Regency Hotel in Houston, Texas.

1. The Council unanimously agreed to oppose the "Small Business Motor Fuel Marketer Preservation Act of 1981" introduced in the 97th Congress on 28 January 1981, known as HR 1362 and the companion Senate Bill SB 326.

2. The Council urges all Shell Jobbers to become more familiar with specific provisions of the bill as the Council believes HR 1362 and SB 326 threaten the very foundation of branded marketing by dealers, jobbers, and suppliers, as well as the jobber functional discount.

3. The Council recommends that Shell Jobbers register their concerns and opposition to their Shell Dealers, State Jobber Associations, NOJC, and especially their elected representatives.

Chairman
Jack Robinson
Crystal Petroleum Co.
Corpus Christi, Texas

Alternate Chairman
McKerrall O'Neill
Berwick Bay Oil Co., Inc.
Morgan City, Louisiana

Members
Angus Hines
Angus L. Hines, Inc.
Suffolk, Virginia
James Truesdell, Jr.
J. Austin Oil Co. of Flint
Flint, Michigan
Louis Grimes
Hayes Oil Company
Dotham, Alabama
Bob Bowles
R. H. Bowles Company Inc.
Yakima, Washington

Tommy Munro
Munro Petroleum & Terminal & Co.
Biloux, Mississippi
Joe Horkey
Horkey Oil Company
Lubbock, Texas
Don Pollock
Allied Petroleum
Reno, Nevada

Unquote.

ATTACHMENT 2

TAX SCHEDULE COMPARISON
SEPTEMBER 1981

CITY	TAXES (CPG) FEDERAL	STATE	LOCAL	SALES TAX	TOTAL TAX	DIFFERENTIAL TO MARYLAND
Baltimore, MD	4.0	9.0	0	0	13.0	-
Atlanta, GA	4.0	7.5	0	5.1***	16.6	+3.6
Norfolk, VA	4.0	11.0	0	0	15.0	+2.0
*Washington, D.C.	4.0	13.0	0	0	17.0	+4.0
**Philadelphia, PA	4.0	11.0	3.85	0	18.85	+5.85

*DC +2.0 CPG 6/1/81.

**Philadelphia +3.85 CPG 7/1/81.

***Represents the sales tax on an ex Federal & State Unleaded Regular price of $1.28. The sales tax on an ex Federal & State Leaded Regular price of $1.05 would be 4.2 cpg.

Pricing Services - Sales Services
October 14, 1981 (HTB)

27/0848
ATTACH/2

ATTACHMENT 2A

RETAIL PRICES OF LEADED REGULAR SELF-SERVE GASOLINE*

	ATLANTA	NORFOLK	BALTIMORE	WASHINGTON, D.C.	PHILADELPHIA
JUNE 1980					
Actual	$1.2095	$1.1746	$1.1968	$1.2214	$1.2188
Tax Adjusted	1.1805	1.1546	-	1.2014	1.1988
SEPTEMBER 1980					
Actual	1.1624	1.1762	1.1668	1.2110	1.1973
Tax Adjusted	1.1354	1.1562	-	1.1910	1.1773
NOVEMBER 1980					
Actual	1.1577	1.1505	1.1392	1.1986	1.1969
Tax Adjusted	1.1307	1.1305	-	1.1786	1.1769
JANUARY 1981					
Actual	1.2297	1.1926	1.1843	1.2509	1.2639
Tax Adjusted	1.1987	1.1726	-	1.2309	1.2439
FEBRUARY 1981					
Actual	1.3187	1.2806	1.2721	1.3314	1.3327
Tax Adjusted	1.2857	1.2606	-	1.3114	1.3127
MARCH 1981					
Actual	1.3212	1.3237	1.3081	1.3360	1.3442
Tax Adjusted	1.2882	1.3037	-	1.3160	1.3242
APRIL 1981					
Actual	1.3098	1.3215	1.2907	1.3239	1.3271
Tax Adjusted	1.2768	1.3015	-	1.3039	1.3071
MAY 1981					
Actual	1.2977	1.3082	1.2685	1.3078	1.3135
Tax Adjusted	1.2657	1.2882	-	1.2878	1.2935
JUNE 1981					
Actual	1.2827	1.2927	1.2605	1.3012	1.3051
Tax Adjusted	1.2507	1.2727	-	1.2612	1.2851
JULY 1981					
Actual	1.2625	1.2773	1.2452	1.2863	1.3252
Tax Adjusted	1.2315	1.2573	-	1.2463	1.2667
AUGUST 1981					
Actual	1.2533	1.2656	1.2372	1.2766	1.3238
Tax Adjusted	1.2223	1.2456	-	1.2366	1.2653
SEPTEMBER 1981					
Actual	1.2457	1.2571	1.2296	1.2703	1.3090
Tax Adjusted	1.2157	1.2371	-	1.2303	1.2505

*Source: Lundberg Survey Inc.

27/D848
ATTACH/2A

Pricing Services - Sales Services
10/15/81
(PBT)

ATTACHMENT 2B

RETAIL PRICES OF UNLEADED SELF-SERVE GASOLINE*

	ATLANTA	NORFOLK	BALTIMORE	WASHINGTON D.C.	PHILADELPHIA
JUNE 1980					
Actual	$1.2599	$1.2253	$1.2441	$1.2620	$1.2561
Tax Adjusted	1.2289	1.2053	-	1.2420	1.2361
SEPTEMBER 1980					
Actual	1.2381	1.2285	1.2189	1.2602	1.2355
Tax Adjusted	1.2081	1.2085	-	1.2402	1.2155
NOVEMBER 1980					
Actual	1.2344	1.2059	1.1934	1.2504	1.2334
Tax Adjusted	1.2044	1.1859	-	1.2304	1.2134
JANUARY 1981					
Actual	1.3080	1.2461	1.2400	1.3038	1.2994
Tax Adjusted	1.2760	1.2261	-	1.2838	1.2794
FEBRUARY 1981					
Actual	1.3953	1.3327	1.3279	1.3853	1.3700
Tax Adjusted	1.3593	1.3127	-	1.3653	1.3500
MARCH 1981					
Actual	1.3995	1.3778	1.3635	1.3918	1.3877
Tax Adjusted	1.3635	1.3578	-	1.3718	1.3677
APRIL 1981					
Actual	1.3918	1.3764	1.3485	1.3814	1.3680
Tax Adjusted	1.3558	1.3564	-	1.3614	1.3480
MAY 1981					
Actual	1.3764	1.3651	1.3256	1.3680	1.3515
Tax Adjusted	1.3404	1.3451	-	1.3480	1.3315
JUNE 1981					
Actual	1.3649	1.3526	1.3168	1.3615	1.3466
Tax Adjusted	1.3289	1.3326	-	1.3215	1.3266
JULY 1981					
Actual	1.3446	1.3383	1.3011	1.3458	1.3624
Tax Adjusted	1.3086	1.3183	-	1.3058	1.3039
AUGUST 1981					
Actual	1.3350	1.3248	1.2926	1.3364	1.3603
Tax Adjusted	1.2990	1.3048	-	1.2964	1.3018
SEPTEMBER 1981					
Actual	1.3250	1.3170	1.2843	1.3287	1.3502
Tax Adjusted	1.2890	1.2970	-	1.2337	1.2917

*Source: Lundberg Survey Inc.

27/D#43
ATTACH/2A

Pricing Services - Sales Services
10/14/81
(FBT)

ATTACHMENT 2C

DTW & RACK REGULAR LEADED & REGULAR UNLEADED PRICES*

	ATLANTA	BALTIMORE	NORFOLK	PHILADELPHIA	WASHINGTON
REGULAR LEADED					
Shell	106.90	107.30	107.30	110.80	107.00
Exxon	106.60	107.30	107.50	107.20	107.80
Amoco	105.70	107.90	108.10	108.00	108.20
Gulf	106.80	108.00	108.00	108.20	108.10
Mobil	106.80	108.10	109.20	108.20	108.00
Texaco	106.70	107.30	109.90	107.85	107.50
Chevron	106.20	107.90	-	107.90	107.90
Phillips	106.60	-	108.00	-	-
Union	107.35	110.00	108.50	-	-
Arco	-	108.50	109.00	108.00	108.75
Citgo	108.20	107.40	108.30	108.30	107.90
Sun	-	107.80	107.90	112.20	109.10
MAJOR AV.	106.63	107.71	108.43	108.73	107.53
INDEPENDENT AV.	101.73	102.81	102.62	102.49	103.42
REGULAR UNLEADED					
Shell	110.90	111.30	111.30	114.80	111.00
Exxon	110.60	111.30	111.50	111.20	111.80
Amoco	109.70	111.90	112.10	112.00	112.20
Gulf	110.80	112.00	112.00	112.20	112.10
Mobil	110.80	112.10	113.20	112.20	112.00
Texaco	110.70	111.30	113.90	111.85	111.50
Chevron	110.20	111.90	-	111.90	111.90
Phillips	110.60	-	112.00	-	-
Union	111.35	114.00	112.50	-	-
Arco	-	111.50	112.00	111.00	111.75
Citgo	112.70	111.90	112.80	112.80	112.40
Sun	-	111.80	111.90	115.60	113.10
MAJOR AV.	110.63	111.71	112.34	112.68	111.43
INDEPENDENT AV.	105.73	106.61	106.46	106.19	107.22

*Source: Lundberg Survey Inc.: Excludes all Taxes

27/P#62
DTW

Pricing Services - Sales Services
10/14/81
(FHT)

Senator **Grassley**. I am pleased now to call a panel of Jack Pester and Jesse Winzenried to the table now.

It is my pleasure to introduce a friend and community leader from Des Moines, Iowa, Jack Pester.

He is founder of the Pester Corp. of Des Moines, Iowa.

His corporation has grown immensely since I have known Jack. I think this is largely due to his ingenuity and great business sense.

I would relate this for the committee, Jack: When I first came to your office, although I had known you for a long period of time before I ever actually came to your office, it was late one evening and you were working. It was snowing outside.

I think that is probably an example of why you have been so successful. You have been willing to work hard.

I appreciate your coming to Washington to share with us your testimony, as I know you have seen this matter from the standpoint of refiners, jobbers and also from the retail standpoint.

Jesse, we welcome you as well.

Since we do have a vote, I suppose that I should have you give your testimony while I vote. Then I will come back for the questioning.

I think we will let you proceed then with staff present.

STATEMENT OF JACK C. PESTER, CHAIRMAN OF THE BOARD, PESTER CORP., DES MOINES, IOWA

Mr. Pester. My name is Jack Pester. I am chairman of the board of Pester Corp. We are based in Des Moines, Iowa.

We refine products in our Kansas refinery and sell through most upper Midwestern and Rocky Mountain States on a wholesale level to jobbers and dealers.

We operate retail service stations that are directly operated in nine Midwestern and Rocky Mountain States.

I began my career as a service station dealer. I later became a jobber.

In 1975, I purchased a refinery in Kansas which then supplied our 100 and some retail service stations plus a number of other dealers and jobbers.

I am presently president of the Independent Refiners Association of America, more commonly referred to as IRAA.

Although IRAA and we are not covered by the retail marketing divorcement provision, small and independent refiners remain opposed to S. 326, especially to its divorcement provisions.

Small and independent refiner marketers have developed and continue to practice a competitive strategy which has as a primary component efficient and effective gasoline marketing.

As competitors with the major oil companies, our survival depends in part upon our continued flexibility and ability to quickly respond to changes in consumer needs.

In addition to having a greater assured supply of crude oil than independent refiners, the majors have established vast marketing networks, often relying upon dealer outlets which enable them to maintain a substantial market position in much of the Nation.

Despite the intent behind this or similar bills, we are certain that the majors will survive as the dominant force in gasoline marketing. However, we are concerned about the ultimate effects upon small and independent companies of any legislation which dictates permissible approaches for selling gasoline. This is particularly the case now in this period of adjustment to decontrol and declining gasoline demand.

Small and independent companies do not have the market power which comes from an extensive, well-established dealer network supported by nationally advertised name brands.

We have been able to provide healthy competition in the marketplace, however, by relying upon our other strengths. We have kept our advertising and other overhead costs down, which has enabled us to engage in vigorous price competition.

We have introduced innovative marketing approaches and have been able and willing to modify both the nature and location of our outlets.

We have sought to serve the neighborhoods and regions of the country where the majors have provided the least service.

For example, in recent years, we have provided services in inner cities and rural communities which major companies have withdrawn from.

If dealers are shown to be the victims of certain abusive supplier practices, Congress should address those practices directly. The challenge to Congress is to identify specific problems and to address them through precise limited remedies, rather than through unnecessary extensive and potentially dangerous legislation.

Attempts to restructure any complex industry should be undertaken only with great care after a clear showing of intractable problems and only as a last resort after less drastic solutions have become ineffective.

We certainly do not deny that the petroleum marketing is undergoing great change. We are well aware of that and of the reductions in overall and regional gasoline demand.

Significant numbers of dealers and marketers and refiners are going out of business. We know, for example, that since decontrol perhaps 40 to 50 small and independent refiners have closed their operations.

We believe that because of the critical importance of the petroleum industry to the Nation, Congress must review the changes which are taking place and seek to insure that competition is evident within all segments of the petroleum industry.

We agree that Congress should carefully address anticompetitive practices, including abuses related to vast differences in market power.

It can do so, however, without taking that seemingly easy course of mandating structural change.

We believe that what is actually happening here is that certain branded dealers are seeking special legislation to protect themselves from the economic realities with which the entire industry is faced.

The sweeping measures which these dealers are urging are being opposed by representatives of all the various industry sectors, including a range of independent jobbers and marketers.

One reason for this widespread opposition to legislation such as S. 326 is that we know that this bill will not solve the dealers' problems. Their dilemma is one which we all share and which relates directly to the realities of competition in a time of declining demand.

We fear that because the difficult market situation will continue, the supporters of this measure will go on to seek and protect themselves from competition with other classes of retailers as well.

In so doing, they could rely upon S. 326 as establishing a startling precedent for Government protection of one class of competitors by the means of the blanket exclusion of other classes.

As we have said, we are concerned that this bill may represent just one aspect of this effort to eliminate competition in the marketplace. We also are facing this in many State legislatures, even though the bill has been passed in very few.

If this bill were to be marked up and come out, we feel that it would be extremely important that we see some preemptive language in the bill also. Otherwise, you are going to have the whole marketplace and the whole competitive situation in this country in a real mess.

Thank you.

Ms. TIFFANY. Thank you, Mr. Pester.

Mr. Winzenried, would you like to summarize your statement?

STATEMENT OF JESSE D. WINZENRIED, GROUP VICE PRESIDENT, CROWN CENTRAL PETROLEUM CORP., BALTIMORE, MD.

Mr. WINZENRIED. Thank you.

My name is Jesse Winzenried. I am with Crown Central Petroleum Corp.

We are classified as a small refiner. We have one refinery with a capacity of 100,000 barrels a day. We sell gasoline through a little more than 200 retail service stations.

We sell about half our gasoline through our own stations and sell the remainder at wholesale.

Of these retail outlets that we have, a little more than one-third are lessee dealer operated.

I am going to discuss today the experience in Maryland under divorcement where we have 46 stations, 35 of which were lessee dealer operated before the Maryland legislation required divorcement, so we only had to divorce ourselves of 11 stations. It still had a significant effect.

Our facts show that consumer prices have risen two-thirds of 1 cent to 4 cents per gallon due to the divorcement in Maryland.

Louis Goldstein, the Maryland State comptroller, had taken figures from Platt's Oilgram and the Lundberg Letter. He stated, and I quote:

"We find that in virtually every case, prices reported in Baltimore are lower than the other East Coast cities and the national average."

Those were postdivorcement figures.

As has been mentioned already here today, it was shown that those figures did not really take into account the difference in State and local taxes from one locality to another.

In taking that into account, we showed that postdivorcement Maryland retail gasoline prices, when corrected to reflect Maryland taxes in relation to others—and the Maryland taxes are lower—appear to be right in the middle of all those cities compared.

Our facts were further corroborated by Congressman Bedell's staff who reviewed the attachments which are supplied for the record of the House hearing last spring and are attached to my full report, which I hope will be included in the record.

Congressman Bedell's staff found: "The data presented by Crown substantiates their statement—namely that postdivorcement prices in Baltimore are right in the middle of other east coast cities."

The information available to the House staff as stated in the hearing record was insufficient for a complete analysis. What is really needed to discern the impact of divorcement on prices is a comparison of price levels and time periods both before and after divorcement.

Therefore, we reviewed additional data from the Lundberg Letter this past summer in order to determine the predivorcement level of Baltimore prices compared to other east coast cities.

The comparison shows that Baltimore prices, after adjusting for differing State and local excise taxes were less by eighty-eight one-hundredths of a cent per gallon in the same months used by Mr. Goldstein.

Postdivorcement Baltimore prices were only two-tenths of a cent less in the same months.

Thus, there was an upward swing of two-thirds of a cent, which appears to have increased as 1981 has progressed.

For example, in June 1981, tax adjusted retail prices, according to the Lundberg Letter data, were 3.9 cents less in Philadelphia than Baltimore, 6.55 cents less in Newark, N.J., and 9.85 cents less on Long Island, N.Y.

In short, Baltimore consumers apparently previously enjoyed a benefit which now has been lost due to divorcement.

We conclude from the Lundberg Letter data that divorcement has increased consumer prices by two-thirds of a cent per gallon in Maryland up to last winter.

These Lundberg Letter data which are based on all marketers' prices are corroborated by our analysis of our own dealer margins.

A comparison of our Maryland stations which were divorced with our Virginia stations that remained company operated is even more striking. These comparative dealer margins are given in attachment V which will be a part of the record.

About 1 year prior to divorcement, in July and August 1978, Maryland Crown lessee dealers on the average were charging 1.41 cents and 0.95 cents more markup than the Virginia Crown company-operated stations in that adjacent State.

These are areas characterized by similar economic and demographic conditions.

One year after divorcement, in July and August 1980, Maryland dealers had increased their margins and were charging 4.3 and 3.57 cents more than the Virginia company-operated stations.

More recently, in July and August of this year, Maryland Crown dealers were charging 4.25 and 5.66 cents more than the Virginia retail group.

As Crown's pricing policy at its Virginia company-operated stations and to its Maryland lessee dealers did not change with divorcement, the increase in dealer margins were borne by Maryland consumers.

All of these periods were of adequate supply in which the market rather than the DOE rules was setting prices.

Crown data shows clearly that Maryland's lessee dealers increased their margins relative to the neighboring Virginia company-operated outlets when they no longer had to meet in-State company stations' competition—to the tune of more than 4 cents at present.

Both the Lundberg Letter and Crown's own data suggest that divorcement has clearly increased consumer costs in Maryland by two-thirds of 1 cent to 4 cents per gallon.

Applied to the approximately 100 billion gallons of gasoline sold annually in the United States, divorcement would increase consumer costs nationally by approximately two-thirds of a billion to $3 billion per year.

This empirical result supports intuitive economic logic: Restricting the number of sellers of any product—be it soap, airlines, beer, or gasoline—tends to increase the price to consumers and not to decrease it.

In summary, divorcement is not proconsumer; it is anticonsumer. It protects a select group of marketers.

By restricting the number of competitors allowed in a market, it tends to raise the price of the product sold by those sellers.

The pressure from dealers for divorcement comes not from any charitable motive for consumers but rather from knowledge that increased profits from higher prices will be the result.

Thank you for the opportunity to present this statement.

Senator GRASSLEY. We have questions for both of you.

I will start with you, Mr. Winzenried.

I would like to have you comment on the following claim:

The claim is made that it only takes one company-operated station in a given area to drive the dealer operated stations in that area out of business.

For example, an Iowa dealer came to me the other day with an invoice indicating his cost of $1.24 a gallon for gasoline.

Gasoline through company-operated stations in the same area was selling at $1.16 a gallon. This was not the same refiner but refiners' daily prices differ usually no more than about seven-tenths of a cent per gallon.

I do not see how a dealer can continue operating under these circumstances.

I also understand that over 100 cases of the same type of practice have been documented and were submitted during House testimony on a similar bill earlier. That is what I would like to have you comment on, particularly the situation where one person was paying $1.24 per gallon and the next one $1.16.

How can a dealer continue operating with that type of competition?

Mr. WINZENRIED. I cannot comment except from my own experience.

I can tell you this though just as an example.

Refiners themselves are paying as much as $4 and $5 per berrel difference in price for their charge stock for their refineries at times.

There is a wide variation. There is not that seven-tenths of 1 cent you are talking about in refinery prices from one refinery to another.

The other thing I can talk about is that our company does not price at its company-operated stations at retail any less than the price it charges to its competitive dealers. It does not do that.

There may be cases of that around the country, and there certainly will be cases where a dealer in one part of town buying supply from one source will have a different buying price than a dealer even on the next corner who is buying from a different supplier.

Senator GRASSLEY. For the record, I should ask you if there is a dispute on this seven-tenths of a cent per gallon, that price was given to me. I think the premise was that was a maximum deviation that they tended to observe over a long period of time.

Do you feel that is accurate?

Mr. WINZENRIED. I think these prices are published weekly. On any given day, there is a far greater range than that in the dealer tank wagon prices charged by the different companies.

Senator **Grassley**. I think the presumption here is that this would be within a geographical area of this supply.

Mr. **Winzenried**. I am talking about that too.

Senator **Grassley**. I have some more questions for you, Jesse. What was the overall effect of divorcement on Crown Central's profitability in Maryland?

Mr. **Winzenried**. The overall effect of divorcement on Crown Central's profitability, unfortunately, I do not have the responsibility for the profit and loss figures as to how they are calculated. I do not have that available broken down for the State of Maryland.

Senator **Grassley**. What would be the effect of S. 326 on Crown's operations and your overall profitability if S. 326 were effective?

Mr. **Winzenried**. We are simply opposed in principle to this idea of carving out a special area or special competitive benefit to a particular group of individuals—whether they be service station dealers or corner grocery stores.

I do not think it makes any difference.

Anytime legislation is passed of this nature, it creates imbalances and problems that nobody can possibly foresee.

We have just gone through a period of about 7 or 8 years of that in the petroleum business. We are just coming out now with decontrol. To enter into another type of restriction of this kind, we are simply opposed to in principle.

Senator **Grassley**. You are making the point that it would necessarily affect your profits?

Mr. **Winzenried**. No; no one can foresee exactly what that would be.

Senator **Grassley**. Did you encounter any kinds of problems in the divorcement of your stations in the State of Maryland?

Mr. **Winzenried**. Certainly we felt that we were giving up something by simply not having any—it simply removed one sizable aspect of competition from the marketplace when we had to divorce ourselves of our company-operated stations.

It also had an effect that could not be foreseen, but there were several other companies that by instituting lawsuits were able to continue company-operating their stations after the others of us had converted over to dealer-operated stations.

That still has not come to an end. That is the type of effect that cannot be foreseen at the time such legislation is passed. There are these imbalances and other inequities that come into play.

Senator **Grassley**. Were you able to find franchises for all of your affected stations in the State of Maryland?

Mr. **Winzenried**. Yes.

Senator **Grassley**. Are you aware of the recent practice of some major refiners to charge credit card fees to the dealers on all products they sell?

Mr. **Winzenried**. Just what I have read in the paper.

Senator **Grassley**. How do you think this will affect the dealer's ability to stay in business?

Mr. **Winzenried**. I think it will depend on the individual situation. I do not think, as a matter of fact, that one company is going to be able to prevail in doing this. If the industry does not go in that direction, the dealers for that particular company are going to be in deep trouble.

Senator **Grassley**. An argument raised by refiners when the subject of open supply is broached is that the refiner must have a guaranteed outlet for his product.

If that is limited by legislation like this, the refiner will pull out of the State.

In the last 5 years, five major refiners have already pulled out of Iowa—Texaco, Gulf, Shell, City Service, and Clarke.

It seems to me that this withdrawal indicates that refiners base their marketing decisions on factors other than a guaranteed outlet for their product.

Consequently, I would like to have your comments on my observation.

Mr. **Winzenried**. I cannot comment on what their reasons really were for that.

We have not pulled out of any State.

Speaking for Maryland, I do know that two companies pulled out of Maryland when the divorcement law went into effect.

Senator **Grassley**. You think there is some legitimacy to the argument that refiners will and could leave with the passage of this legislation?

Mr. **Winzenried**. Yes; I do.

There may be other factors also, but I simply pointed to that as a fact.

Senator **Grassley**. You do not see the evidence that five have left Iowa as contradicting already, without the divorcement legislation, that point made by other major refiners?

Mr. **Winzenried**. There are other reasons.

Certainly divorcement is not the only reason for somebody restructuring his operation. It is difficult to make too broad a conclusion.

Senator **Grassley**. Jack, is it correct that all your stations are company operated?

Mr. **Pester**. Yes.

Senator **Grassley**. How does your street price compare to dealer-operated stations in the same area?

Mr. **Pester**. Historically, as an independent marketer, our pricing is based on a competitive edge, so to speak.

Without a national brand and without a national credit card and without a full-service service station, our marketing philosophy is based on maintaining a competitive situation in the marketplace

Most dealers represent these major oil companies who have these branded programs—the pricing of their credit cards and the other things.

I would say that we are competitive, or slightly less—1 cent perhaps on a self service basis below most majors.

However, I could show you in almost any major market where there are some major oil company dealers that are below our prices in the community.

Senator **Grassley**. Since all your stores are company operated, it is impossible for you to enter into the claimed anticompetitive practices of some of the major refineries. Could you please comment on those practices? Do you believe they are occurring? If so, is there any possible remedy you would suggest?

Mr. **Pester**. The marketplace in 1970 and 1971 and 1972 and 1973 started making a lot of changes. As we look back through history, in many cases, I think a service station was built on every corner to provide an outlet for producers of crude oil. They would refine it, and they would sell it.

I think as early as the late sixties, they began to see that that really was not a good way to market and it was not economical and a lot of changes were going to have to be made and that they were going to have to make a return on their investment in marketing and refining.

In 1972 with the first Cost of Living Council rules, a lot of practices were frozen in place.

A lot of things that are happening in the marketplace today, I think, are a direct result of controls. There were a lot of things that would have gradually worked out of the marketplace over time that are now at the time of decontrol——

It is like a pent-up demand. It is all of a sudden there. Companies are having to do things—close operations and change methods of operation. They are looking at credit card costs and the cost of credit and maintaining credit for the consumer.

We have tremendous changes, and they were pent-up changes that are beginning to happen.

There are things that happen. I am sure that there are people who work for my company—I know there are—that when they come across my desk they say: Why did we do that? Maybe a service station manager or somebody will come in to me and say: Why are you doing this to me?

Sometimes those people are right. However, I do not think there is as much of that going on as is represented.

Anytime you hold a hearing about something that is wrong with our system, you do not get the hundreds of thousands of people who really think this is a great system.

This country has given me an opportunity to make money. They are satisfied. They stay home and work.

You hear from the people who are disgruntled and rightfully so.

What I am saying is that there are these things going on. I do not think the management of Shell or Amoco or Pester or Vickers or Crown Central want those things to go on. I think as time goes on, they will correct those things.

If there is value in this hearing, I do not think it is in coming up with a bill for divestiture. I think it provides a forum where some of these things come forward and chief executives of companies have an opportunity to say: We cannot do this to people.

I know a lot of these people, and that intent is not out there to harm dealers.

The worst thing that happened to the system was controls, and changes are being made.

It will be a good business for people.

As top management really learns that some of these abuses go on, they will change it because they know that they cannot run companies like that. They will admonish the people in their organization to do these things.

All I am saying is that we are hearing from the disgruntled people, and we always have that. We have it in welfare and we have it every place else, but there are a lot of very happy people with this industry out there also.

Senator GRASSLEY. Let me comment on what you said, because obviously there are several ways to accomplish a goal and passing a bill is not necessarily one of them, although it is one that gets the most attention.

Do you feel, since this issue has been up for discussion, for 3 years and maybe longer than that, that major companies, or any company, that has been accused through the hearing process of certain bad practices that there has been enough discussion in the business and trade associations that people are more cognizant of these complaints so there might be less need for the legislation?

I would have to be frank with you and say that I have not heard any lessening of demand for the legislation in the 2 or 3 years since people have been contacting my office on it.

In other words, I guess I am hoping what you surmise can happen. I am asking whether or not you feel there has been any progress made.

Maybe getting closer to the passage of the legislation, we will see a change.

Mr. PESTER. I think there continue to be dissatisfied people.

Let's take the State of Iowa. I think our petroleum demand is down 16 or 17 percent. That means that those marginal outlets are going to be even less profitable.

When you have your demand go down by 16 or 17 percent, there is a lot of fighting on the street to try to get somebody else's customers, and there are always losers.

I think as time goes on that this industry has to adjust to 16 or 17 percent less demand. There are some people who are going to go out of business, and they are not going to be happy.

Every time I get in a fight with my wife, I tend to want to blame her and not myself. It is a natural thing to blame the other guy.

Nobody likes to say somebody else is a better businessman than he is or somebody else made a better deal with an oil company or somebody else has a better location.

There are going to be a lot of unhappy people.

I think we will continue to see disgruntled people, but I have to say that a lot of the practices that were maybe unfair, some of those were kind of locked in place because business practices for a number of years were locked in place by controls.

I have to say that I think when you get in a very competitive environment like this that people who have ability will excell. There will be a lot of money made for the man with the better idea or the man with the better mousetrap or the man with the better personality running the service station or a more aggressive salesman.

Really, when there is 17 percent less to be sold, we are going to have a lot of people be disgruntled.

Senator GRASSLEY. On the other hand, let me interject here before I ask you my last question:

I think over a long period of time that we have not, as Senators and Congressmen, heard just from those people who are about ready to go out of business. Probably we have heard from very successful people and people who are not threatened either—just to give you my observation.

My last question is: As I understand your position, you are concerned about the possibility of future expansion of the divorcement provisions, assuming that this legislation is passed.

Do you believe it is likely that this might in fact occur?

Mr. **Pester**. Let me give you a scenario.

I do not have it with me. I made a copy of it at home, and I will be glad to send it to you and submit it for the record.

In a magazine called "Petroleum Management," I believe, the executive director of the Connecticut Service Station Dealers Association made the statement that: We have eliminated the refiners from marketing in the State of Connecticut and now we are going to eliminate the jobbers.

The jobbers originally had alined with them in support of this bill.

It appears to me that this would be the scenario that would happen.

Let us say in a particular State, or after a Federal bill, the next thing that would happen after this bill went into effect is that independent and small refiners would still be able to operate directly. Jobbers would still be able to operate directly, but the major refiners would not be, and they would be distributing through dealers.

The next scenario would be that the dealers and the major oil companies would band together and say: Let us make sure that the independent refiners and the jobbers do not have this advantage. The next bill that would be before a committee like this would be one to eliminate oil jobbers.

If you look at the State of Iowa, for instance—that is a big part of our distribution—900 independent businessmen would be eliminated from operating service station directs, plus a number of independent refiners.

That would be just the next scenario.

What I am saying is that our company would have a lot of problems existing. Because of the nature of the business, we need to operate on a direct basis.

What you would have in the State of Iowa, Senator, are very few major oil companies supplying dealers who in many cases would not have to be necessarily that competitive.

I think the consumer in that State would be hurt, and I think Iowa then would be dependent on the seven sisters, or whatever you want to call it.

What this is is just an elimination process. We will get rid of the majors this session of Congress. The next session of Congress, we will get rid of the jobbers and the independent refiners. Then we will have the dealers marketing for these major oil companies. That is all that is going to be left.

That is my real fear of what is happening.

This bill as it is written might even look like it gives somebody like us a little bit of an advantage, but this is not the first bill that we will see.

I am sure you are going to be in the Senate for a long time. If this bill succeeds, your next question is:

Now they say that the independent refiners and jobbers are causing them too many problems.

What they need to do is get out in the street and compete and realize that a few of them are going to be gone.

It is the same in farming and automobile dealerships. It is the same in the corner drugstore.

This economy in this country is vital enough to absorb the workers—particularly those workers who are aggressive and businessmen who are aggressive. There is a lot of opportunity here, but we cannot lock in place old, obsolete systems and expect to live with them forever.

Senator **GRASSLEY**. Does Senator Metzenbaum have any questions?

Ms. **BAKER**. Yes; I have a few questions for Mr. Winzenried.

You indicated that your company does not undersell your lessee dealers. Is that correct?

Mr. **WINZENRIED**. That is correct.

Ms. **BAKER**. Your company is not covered by this legislation is it?

Mr. **WINZENRIED**. No; I do not believe it is covered by it.

We are here, as I mentioned before, just because we oppose this type of legislation in principle.

Ms. **BAKER**. You indicated that there are two marketers that left the market in Maryland after divorcement.

Mr. **WINZENRIED**. Conoco and Ashland were the two companies that left the State.

Ms. **BAKER**. Our information is that Ashland sold its interest to Amoco, but that it continues to do business with jobbers and other dealers in the State of Maryland; is that correct?

Mr. **WINZENRIED**. Yes. I meant they left the service station business. They are not operating with any of their own service stations in Maryland.

Ms. **BAKER**. They are still supplying the product in Maryland.

Mr. **WINZENRIED**. Yes; I am sure they probably are as wholesalers.

Ms. **BAKER**. Thank you.

Ms. **TIFFANY**. Thank you, Mr. Winzenried.

Mr. **WINZENRIED**. Thank you.

[Material follows:]

STATEMENT OF

JACK C. PESTER
CHAIRMAN OF THE BOARD OF PESTER CORPORATION

Mr. Chairman and members of the Committee, my name is Jack Pester and I am Chairman of the Board of Pester Corporation, headquartered in Des Moines, Iowa. Pester Corporation markets and refines petroleum products, primarily gasoline, in the midcontinent and Rocky Mountain regions, and has retail gasoline outlets in nine states.

I appreciate the opportunity to appear before you in order to discuss the impact of S. 326 upon small and independent refiner-marketers. I began my business as a dealer and then became a jobber and finally a refiner-marketer. Because of my varied experience in gasoline marketing, as well as because of my role as President of the Independent Refiners' Association of America, I believe that I am well situated to discuss the concerns that small and independent refiners have about this bill.

Although we are not covered by its retail marketing divorcement provision, small and independent refiners remain opposed to S. 326, and especially to its divorcement requirement. This is because we are vitally concerned about any legislation which impacts upon the structure of the gasoline marketplace. More importantly, the precedent which the divorcement provision of S. 326 would establish could be devastating to our sector of the industry.

Small and independent refiner-marketers have developed and continue to practice a competitive strategy which has as a primary component efficient, effective gasoline marketing. As competitors with the major oil companies our survival depends, in part, upon our continued flexibility and ability to quickly respond to changes in consumers' needs. In addition to having a greater assured supply of crude oil than independent refiners, the majors have established vast marketing networks (often relying upon dealer outlets) which enable them to maintain a substantial market position in much of the nation. Despite the intent behind this or similar bills, we are certain that the majors will survive as the dominant force in gasoline marketing. However, we are concerned about the ultimate effects upon small and independent companies of any legislation which dictates permissible approaches for selling gasoline. This is particularly the case now in this period of adjustment to decontrol and declining gasoline demand.

Small and independent companies do not have the market power which comes from an extensive, well established dealer network supported by nationally advertised brand names. We have been able to provide healthy competition in the marketplace, however, by relying upon our other strengths. We have kept our advertising and other overhead costs down, which has enabled us to engage in vigorous price competition. We have introduced innovative marketing approaches and have been able and willing to modify both the nature and location of our outlets. We have sought to serve the neighborhoods and regions of the country where the majors have provided the least service. For example, in recent years we have provided service in inner cities and rural communities from which major companies have withdrawn. In other words, the keystone of the strategy of small and independent refiner-marketers has been to respond quickly and effectively to consumer demand. By recognizing the importance of our flexibility, and by concentrating on offering consumer alternatives, small and independents have become a significant competitive force in an industry which might otherwise be dominated by relatively few companies.

The flexibility which is fundamental to our marketing strategy has become more important than ever in the recent period of reduced demand for petroleum products. We believe that in the long run small and independent refiner-marketers, and other independent marketers, will be able to continue to provide vigorous competition in gasoline marketing. To do so, however, we must be able to continue to respond promptly to changing consumer needs. We fear that renewed government regulation could limit our ability to make the necessary responses. Therefore, we are opposed to government intervention in the gasoline marketplace unless it is tightly tailored to otherwise unresolvable problems. We are particularly opposed to government-mandated divorcement, which flatly excludes certain competitors from the market. If dealers are shown to be the victims of certain abusive supplier practices, Congress should address those practices directly. The challenge to Congress is to identify specific problems and to address them through precise, limited remedies, rather than through unnecessarily extensive, and potentially dangerous, legislation.

Attempts to restructure any complex industry should be undertaken only with great care, after a clear showing of intractable problems, and only as a last resort after less drastic solutions have been shown ineffective. We do not believe that there has been adequate showing of the need to abandon other approaches and to take the severe path of divorcement, divestiture, or growth limitations. In fact, the Department of Energy's Title III Study*, the most in-depth study related to the issue, concluded that "no additional actions are necessary in order to ensure a functioning competitive gasoline market."

We certainly do not deny that petroleum marketing is undergoing great change. We are well aware that, because of reductions in overall and regional gasoline demand, significant numbers of dealers, marketers and refiners are going out of business. We know, for example, that since decontrol perhaps 40 to 50 small and independent refiners have closed their operations.** We believe that, because of the critical importance of the petroleum industry to the Nation, Congress must review the changes which are taking place and seek to insure that competition is evident within all segments of the petroleum industry. We agree that Congress should carefully address anticompetitive practices, including abuses related to vast differences in market power. It can do so, however, without taking the seemingly easy course of mandating structural change.

We believe that what is actually happening here is that certain branded dealers are seeking special legislation to protect themselves from the economic realities with which the entire industry is faced. The sweeping measures which these dealers are urging are being opposed by representatives of all the various industry sectors, including a range of independent marketers. One reason for this widespread opposition to legislation such as S. 326 is that we know that this bill will not solve the dealers' problems -- their dilemma is one which we all share and which relates directly to the realities of competition in a time of declining demand. We fear that, because the difficult market situation will continue, the supporters of this measure will go on to seek to protect themselves from competition with other classes of retailers, as well. In so doing, they could rely upon S. 326 as establishing a startling precedent for government protection of one class of competitors by the means of the blanket exclusion of other classes.

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* Office of Competition, U.S. Department of Energy, The State of Competition in Gasoline Marketing, Book 1 at p. 238 (1981).

** See, e.g., "Surplus Capacity Jolts Small Refiners," Oil and Gas Journal. pp. 71-76 (Sept. 21, 1981).

It is axiomatic that if competition is reduced by the exclusion of whole categories of competitors, not only the excluded marketers and their employees will suffer, but consumers will suffer as well. Furthermore, if Congress gives in to the temptation of beginning to rearrange the very structure of the industry, it will set off a chain of endless and unpredictable events. We have seen, already, that price and allocation controls, and the process of their gradual amendment, had a devastating and unforeseen impact upon many small competitors, including the dealers. For example, some dealers went out of business when allocation regulations prevented them from securing the volumes of gasoline necessary for their economic viability. We fear that the even more drastic step of determining how the industry will be organized will set off a similar wave of developments, and that, in the end, it will be the small and independent sector whose competitive strength is undercut.

As we have said, we are concerned that this bill may represent just one aspect of an effort to eliminate categories of competitors within the gasoline marketplace. As you know, a number of states are considering various forms of legislation designed to regulate the petroleum industry. Among the pending proposals are several bills which resemble S. 326. Although it appears that most states will reject the divorcement approach, others could adopt it. It would be wasteful, costly and confusing to permit both state and federal regulation of the most basic aspects of the petroleum industry, particularly if state laws differ greatly among themselves, and from emerging federal law.

Therefore, we believe that, if this Committee does report out S. 326, it should include a provision expressing the intent of Congress that regulation of the structure of the petroleum industry, at least for the next few years, will be within the exclusive federal jurisdiction. We recommend Federal preemption of any state law or regulation requiring the divorcement or divestiture of retail gasoline marketing operations by refiners.

I appreciate the opportunity to be with you here today and will try to answer any questions you may have.

PREPARED STATEMENT OF JESSE D. WINZENRIED

Good Morning. I am Jesse D. Winzenried, Group Vice President, Crown Central Petroleum Corporation. It is a privilege to appear before you today to testify on S.326. I am going to discuss the experience in Maryland under divorcement. The facts show that consumer prices have risen two-thirds of one cent to 4 cents per gallon due to divorcement.

Crown is an independent refiner and marketer of petroleum products headquartered in Baltimore, Maryland. We own and operate a 100,000 barrel per day high-conversion refinery located near Houston, Texas. We market the gasoline produced in our refinery at both the wholesale and retail levels in Texas, Alabama, Georgia, South Carolina, North Carolina, Virginia, Maryland, Pennsylvania, New Jersey and New York. Our more than 200 Crown retail multi-pump gasoline stations throughout these states are supplied from our Houston refinery. Of these retail outlets, 71 are dealer-operated and the remainder are company-operated. Crown has 46 multi-pump stations in the state of Maryland. Eleven of these retail stations were affected by the Maryland legislation requiring divorcement.

In his testimony before Congressman Bedell's Subcommittee March 31, 1981, Louis L. Goldstein, Maryland State Comptroller, stated,

> The effects of Maryland's divorcement law have been beneficial to the consumer and to the retail service station dealer. Arguments have been advanced that divorcement causes increased prices. Our office has conducted a study of prices and apparent dealer margins as reported by the Platt's Oilgram and the Lundberg Letter. In comparing data for similar East Coast cities - we find that in virtually every case prices reported in Baltimore are lower than the other East Coast cities and the national average....

> I firmly believe that Maryland has lower prices and a more stable marketplace because of our divorcement law.

Mr. Goldstein's statement attempted to address the question of the impact of divorcement on retail prices via a table comparing retail prices of unleaded regular self-serve gasoline (about one-fourth of total retail gasoline sales) in Baltimore, with prices in four other U.S. cities, and the U.S. average, ignoring taxes. A copy of this table is appended as Attachment I of our submission.

However, to simply compare retail gasoline prices can be misleading if state and local tax rates are different. In fact, state excise and local sales taxes were higher in most of the other cities surveyed than in Baltimore. The Maryland taxes included in the pump price were 0 to 9 cents lower than in the other states in the periods compared. These differences in state and local tax rates are shown in Attachments II and III. We would expect that Baltimore retail prices would have been less in reflection of Maryland's lower taxes on gasoline.

In fact, when pump prices in other localities are adjusted by subtracting the higher tax paid in other locations, Baltimore prices are higher in 11 of the 20 comparisons reported. Only in 9 of 20 are Baltimore prices lower. This is shown in Attachment III.

Thus, post-divorcement Maryland retail gasoline prices, when corrected to reflect lower Maryland taxes, appear to be right in the middle of the cities compared.

Congressman Bedell's staff reviewed Attachments I, II, III and V, which were supplied for the record of the House Hearings last Spring (in Appendix T of that Hearing Record) and found that "The data presented by Crown substantiates their statement [That post-divorcement prices in Baltimore are right in the middle of other East Coast cities]."

The information available to the House staff, as stated in the Hearing Record, was insufficient for a complete analysis. What is really needed to discern the impact of divorcement on prices is a comparison of price levels in time periods both before and after divorcement. Therefore, we reviewed additional data from the Lundberg Letter this past summer in order to determine the pre-divorcement level of Baltimore prices compared to other East Coast cities. This data appears in Attachment IV.

Baltimore prices for full service leaded gasoline were compared to other East Coast cities using pre-divorcement data from the Lundberg Letter. (Full service leaded gasoline was selected because of wide usage and data availability.) The comparison shows that Baltimore prices, after adjusting for differing state and local excise taxes, were less by 0.88 cents per gallon in the same months used by Mr. Goldstein.1/ Post-divorcement Baltimore prices were only 0.20 cents less in the same months. Thus, there was an upward swing of 0.68 cents which appears to have increased as 1981 has progressed. For example, in June 1981 tax adjusted retail prices according to the Lundberg Letter data were 3.9 cents less in Philadelphia than Baltimore price, 6.55 cents less in Newark, N.J. and 9.85 cents less on Long Island, N.Y.

In short, Baltimore consumers apparently previously enjoyed a benefit which has now been lost due to divorcement. We

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1/ The 1975-1976 period was chosen because it was the most recent period prior to divorcement in which the market was setting prices. While DOE had regulations setting price ceilings, the market was holding actual prices below the ceiling.

conclude from the Lundberg Letter data that divorcement has increased consumer prices by two-thirds of a cent per gallon in Maryland up to last winter.

These Lundberg Letter data, which are based on all marketers' prices, are corroborated by our analysis of our own dealer margins. A comparison of our Maryland stations which were divorced with our Virginia stations that remained company-operated, is even more striking.

These comparative dealer margins are given in Attachment V. About one year prior to divorcement, in July and August 1978, Maryland Crown lessee dealers on the average were charging 1.41 and 0.95 cents more markup than the Virginia Crown company-operated stations in that adjacent state. These are areas characterized by similar economic and demographic conditions. One year after divorcement, in July and August 1980, Maryland dealers had increased their margins and were charging 4.32 and 3.57 cents more than the Virginia company-operated stations. More recently, in July and August 1981, Maryland Crown dealers were charging 4.25 and 5.66 cents more than the Virginia retail group. This is shown in Attachment V. As Crown's pricing policy at its Virginia company-operated stations and to its Maryland lessee dealers did not change with divorcement, the increases in dealer margins were borne by Maryland consumers.

All of these periods were of adequate supply in which the market, rather than the DOE rules, was setting prices. Crown data shows clearly that Maryland's lessee dealers increased their margins relative to the neighboring Virginia company-operated outlets when they no longer had to meet in-state company stations competition -- to the tune of more than 4 cents at present.

Both the Lundberg letter and Crown's own data suggest that divorcement has clearly increased consumer costs in Maryland by two-thirds of one cent to 4 cents per gallon. Applied to the approximately 100 billion gallons of gasoline sold annually in the United States, divorcement would increase consumer costs nationally by approximately two-thirds of a billion to to 3 billion dollars.

This empirical result supports intuitive economic logic -- restricting the number of sellers of any product, be it soap, taxi cabs, airlines, beer or gasoline, tends to increase the price to consumers, not to decrease it.

In summary, divorcement is not pro-consumer. It is anti-consumer. It protects a select group of marketers. By restricting the number of competitors allowed in a market, it tends to raise the price of the products sold by these sellers. The pressure from dealers for divorcement comes not from any charitable motive for consumers, but rather from knowledge that increased profits from higher prices be the result.

We appreciate the opportunity to testify here today and will attempt to answer any questions you may have.

ATTACHMENT I

RETAIL PRICES OF UNLEADED REGULAR SELF-SERVE GASOLINE* INCLUDING ALL STATE AND LOCAL TAXES

	JUNE '80	SEPT. '80	NOV. '80	JAN. '81	FEB. '81**
Atlanta	$1.2599***	$1.2381	$1.2344	$1.3080	$1.3953
Norfolk	$1.2253	$1.2285	$1.2059	$1.2461	$1.3327
Baltimore	$1.2441	$1.2189	$1.1934	$1.2400	$1.3279
Washington, D.C.	$1.2620	$1.2602	$1.2504	$1.3038	$1.3853
Philadelphia	$1.2561	$1.2355	$1.2334	$1.2994	$1.3700
U.S. Average	$1.2461	$1.2254	$1.2181	$1.2773	$1.3701****

* Per gallon prices reported by the Lundberg Letter

** Reflect decontrol

*** This was reported by Mr. Goldstein as $1.3121, our figure is from the Lundberg Letter.

**** This was reported by Mr. Goldstein as $1.3290, our figure is from the Lundberg Letter.

ATTACHMENT II

COMPARISON OF TAXES ON RETAIL SALES OF GASOLINE

(cents per gallon)

	June 1980			Sept. 1980			Nov. 1980			Jan. 1981			Feb. 1981		
	Excise	Sales	Total Gasoline Taxes	Excise	Sales	Total Gasoline Taxes	Excise	Sales	Total Gasoline Taxes	Excise	Sales	Total Gasoline Taxes	Excise	Sales	Total Gasoline Taxes
* Atlanta, Georgia	.075	4¢	.1250	.075	4¢	.1250	.075	4¢	.1250	.075	4¢*	.1250	.075	4¢*	.1250 ***
Norfolk, Virginia	.09	—	.09	.11	—	.11	.11	—	.11	.11	—	.11	.11	—	.11
Baltimore, Maryland	.09	—	.09	.09	—	.09	.09	—	.09	.09	—	.09	.09	—	.09
**Washington, D.C.	.10	—	.10	.10	6¢**	.18	.10	6¢**	.18	.11	—	.11	.11	—	.11
Philadelphia, Pa.	.11	—	.11	.11	—	.11	.11	—	.11	.11	—	.11	.11	—	.11

*Atlanta Sales Tax Table on all sales under $1.00 a four-cent tax is imposed. On all sales over $1.00 a four-cent tax is imposed on 99¢, and a fraction of the tax is imposed on the remainder.

**D.C. Sales tax was in effect 8/6/80 through 11/30/80. The rates used were:

$1.13 to $1.17/gal. = 7¢/gal. tax
$1.18 to $1.35/gal. = 8¢/gal. tax
$1.36 to $1.53/gal. = 9¢/gal. tax

***Correction

ATTACHMENT III

GASOLINE TAX DATA

DIFFERENCES BY WHICH REGIONAL GASOLINE TAXES EXCEED BALTIMORE GASOLINE TAXES
(data in dollars per gallon)

	JUNE '80	SEPT. '80	NOV. '80	JAN. '81	FEB. '81
Atlanta	.035	.035	.035	.035	.035*
Norfolk	.00	.02	.02	.02	.02
Baltimore	--	--	--	--	--
Washington, D.C.	.01	.09	.09	.02	.02
Philadelphia	.02	.02	.02	.02	.02

RETAIL UNLEADED SELF-SERVE PRICE DIFFERENCES ADJUSTED FOR VARYING TAX LEVELS COMPARED TO BALTIMORE
(data in dollars per gallon)

	JUNE '80	SEPT. '80	NOV. '80	JAN. '81	FEB. '81
Atlanta	-.0192	-.0158	.0060	.0330	.0324*
Norfolk	-.0188	-.0104	-.0075	-.0139	-.0152
Baltimore	--	--	--	--	--
Washington, D.C.	.0079	-.0487	-.0330	.0438	.0374
Philadelphia	-.0080	-.0034	.0200	.0394	.0221

*Corrections

ATTACHMENT IV

COMPARISON OF BALTIMORE LEADED FULL-SERVICE GASOLINE PRICES TO OTHER EAST COAST CITIES

(Prices in other cities, minus Baltimore prices)

PRE-DIVORCEMENT

	June 1975	Sept. 1975	Nov. 1975	Jan. 1976	Feb. 1976	City Average (6/75-2/76)
Atlanta, Ga.	.0223	.0091	.0134	.0105	.0118	.0134
Charlotte, N.C.	.0125	.0045	.0195	.0135	.0205	.0141
Long Island, N.Y.	-.0090	-.0220	-.0250	-.0290	-.0290	-.0228
Norfolk, Va.	.0130	.0120	.0170	.0140	.0150	.0142
Washington, D.C.	.0460	.0330	.0170	.0150	.0150	.0252
Average of All Cities						.0088

POST-DIVORCEMENT

	June 1980	Sept. 1980	Nov. 1980	Jan. 1981	Feb. 1981	City Average (6/80-2/81)
Atlanta, Ga.	-.0010	-.0102	.0209	.0513	.0471	.0216
Charlotte, N.C.	.0036	.0137	.0298	.0185	-.0034	.0124
Long Island, N.Y.	-.0261	-.0543	-.0458	-.0228	-.0312	-.0360
Norfolk, Va.	.0038	.0058	.0190	.0158	.0084	.0106
Washington, D.C.	.0026	-.0530	-.0341	.0488	.0424	.0013
Average of All Cities						+.0020

ATTACHMENT V

COMPARISON OF MARGINS FOR CROWN STATIONS IN MARYLAND AND VIRGINIA

Company records reveal that Crown dealers in Maryland have greater margins than stations operated by Crown in Virginia, both before and after divorcement. The difference by which Maryland exceeds Virginia margins are:

PERIOD	DIFFERENCE (in cents per gallon)
Pre-Divorcement	
July 1978	1.41
August 1978	0.95
Post-Divorcement	
July 1979	4.26
August 1979	3.51
July 1980	4.32
August 1980	3.57
July 1981	4.25*
August 1981	5.66*

Since divorcement, the difference between Maryland dealer margins and Crown company stations margins has further increased.

*Includes dealer rebates. Amount of rebates as follows:

1¢/gallon for sales equaling minimum gallonage requirements.

An additional 7¢/gallon for all sales over minimum gallonage requirements and up to 120% of the minimum gallonage.

Ms. TIFFANY. We will be in adjournment for just a few minutes. Senator Grassley will be right back.

[Recess taken.]

Ms. TIFFANY. While we are waiting for Senator Grassley to return, I think we should continue with the hearing.

Mr. Norman Nicholson is the next witness scheduled. He is vice president of marketing for Marathon Oil Co., in Findley, Ohio.

Mr. Nicholson, if you would give us a brief summary please of your written statement, your entire written statement can be included in the record.

STATEMENT OF G. NORMAN NICHOLSON, VICE PRESIDENT OF MARKETING, MARATHON OIL CO., FINDLEY, OHIO

Mr. NICHOLSON. Thank you.

I will do that.

Marathon opposes S. 326 in its entirety. We are convinced that the wholesale transfer price, open supply, and other provisions mandated by the bill will produce more harm than good, particularly for the consumer.

The committee has heard a lot of testimony about these provisions, so I want to limit my discussion to the divorcement provisions.

Marathon is a medium-size integrated company. We market primarily in the six Great Lake States and in the southeastern area of the country.

For many years, the bulk of Marathon's gasoline has been sold to independent marketers who resell the product under their own private brand names and to independent dealers, jobbers, and distributors who resell the product under the Marathon trademark.

In 1980, about 74 percent of our sales of almost 4 billion gallons of gasoline were made to these independent businessmen. Included in that group are the approximately 2,050 Marathon branded outlets in Indiana, Illinois, Kentucky, Michigan, Ohio, and Wisconsin which are operated by independent marketers and which are primarily full service stations.

The remaining 26 percent of our gasoline is sold through a wholly-owned subsidiary engaged in retailing under secondary brand names. The subsidiary operates approximately 735 of these outlets which are primarily gas and go.

It is these outlets which will be affected by divorcement.

Direct retailing did not become a part of Marathon's marketing strategy until the first half of the seventies. It was dictated by two major changes in consumer buying patterns that occurred between the 1973 Arab embargo and 1976 when the petroleum market stabilized again.

Beginning with the Arab embargo and the subsequent quadrupling of oil prices, segmentation of the gasoline market became more pronounced. More and more motorists shifted away from dealer-run full service stations in search of gasoline-only outlets.

At the same time, motorists were shifting a large part of their car repairs and accessory business to specialty stores such as muffler shops, tire stores, and auto repair shops which offered highly specialized services.

By 1979 there were 53,000 of these specialty stores doing $8 billion worth of business annually.

The impact which they had on the full service station was severe because dealers operating successful full service stations usually depend on repairs plus tire, batteries, and accessory sales for a substantial part of their revenue.

These dramatic changes in consumer buying habits soon became evident to Marathon. Many, though not all of our dealers, lost gallonage, repair trade, and related sales. An unprecedented number left the business, forcing us to close units in which we had large investments.

At the same time, our sales to unbranded jobbers left no doubt that they were picking up customers our dealers were losing.

In short, our experience paralleled data later developed by the DOE in its title III study which showed that dealers lost 5 percentage points—about 5.5 billion gallons in total gasoline market shares—between 1972 and 1980, while jobbers were increasing their retail sales by 13 percentage points—nearly 18 billion gallons annually.

Consumers were telling us where and how they intended to buy gasoline, and the message to Marathon and other similarly situated small and medium-size refiners was unmistakable—adapt and respond to the changing consumer buying preferences or face a declining and unprofitable marketing business.

This change in Marathon strategy was necessary to retain business. It was not tainted by any ulterior motive to run our dealers out of business. We recognize that an important segment of motorists are service conscious consumers. These consumers whose numbers have been relatively stable since 1976 will patronize full service stations because they are willing to pay a little more to get the products and service dealers offer in that kind of outlet.

As I said previously, there are approximately 2,050 Marathon brand stations. They are all operated by independent businessmen—jobbers, distributors, and dealers. They are almost entirely full service stations. They receive the value of the Marathon brand name, advertising, credit cards, dealer training, and all of the other services attendant to a Marathon branded station.

Even the gasolines they sell are different from those sold to our subsidiary or unbranded customers. They are of higher quality containing additives designed to clean and reduce deposit buildup in intake systems. They prevent rust formation in vehicle fuel tanks and assure better fuel economy, and they are advertised as such by Marathon.

It is this type of branded station which we believe will appeal to those consumers who are looking for added value in products and service and are willing to pay a little more.

In contrast, the 735 units operated by our subsidiary are high volume, low margin stations designed to appeal to consumers interested only in price—and low price is what they get.

These no-frills units are almost exclusively gas-and-go, self-service operations which offer no repair service or accessories. They do not take Marathon credit cards, and their only advertising is the posted street price.

Forcing Marathon to lose these units would deprive us of an investment in excess of $200 million and would cost about 4,000 of our employees to lose their jobs.

We do not believe that our no-frill gasoline stations compete with our branded dealers for the same customers. We are convinced that each occupies a different segment of the marketplace, and each competes with other marketers offering similar services in that segment.

If we were trying to get rid of dealers, as has been charged, Marathon's marketing data would look strikingly different from what it does.

There has been little change in the number of Marathon branded stations since 1976. We have negotiated 238 new dealer leases since 1977—not including renewals—and we are currently looking for dealers for 49 locations.

Additional evidence of stability is shown by our subsidiary units which numbered 747 in 1976 and 735 today. These figures, in our opinion, reflect that Marathon has no strategy to take control of the market at the expense of our branded business.

An analysis of volume sold also indicates market steadiness. Between 1976 and 1980, Marathon's percentage of gasoline sold through its subsidiaries ranged from 24.1 to 26.7 percent. We think 1980 will be about the same.

National numbers for refiners reflect the same situation. Refinery operated units nationally were 14,000 to 15,000 from 1976 to 1980 and remain at that level.

Retail marketing divorcement is a concept that has been before Congress for at least 7 years and one which has been considered in a majority of State legislatures since 1979.

Thousands of pages of analysis and comments have been prepared by Government agencies, consumer groups, economists, and almost every segment of the oil industry.

A dozen or more valid objections to retail marketing divorcement have emerged, and our written statement summarizes many of them. There are two I would like to emphasize.

First, the bill applies to only 16 refiners. Second, it impacts primarily in only six States.

As to the first point, the 16 refiners forced into divorcement under the bill are not even the 16 largest. The 13th, 17th, and 18th largest refineries are excluded while the 19th is included.

Of the 14,000 to 15,000 gasoline outlets operated by refiners, only about 8,000 are affected by the bill. The others, plus all jobber-operated units and all convenience stores, would be permitted to continue operation.

There is no logical reason to select these 16 refiners for divorcement. The group does not include all refiners which have company-operated stations.

Only a few of the 16 have any significant number of company-operated retail units, and the 16 have not been chosen on the basis of some alleged, must less proven, market misconduct.

Instead, the 16 refiners were arbitrarily selected by exempting all small and independent refiners as defined by the now inoperative Emergency Petroleum Allocation Act of 1973.

We raise this issue not to argue for a more expansive divorcement provision—divorcement is wrong in any form—but rather to point out the inconsistency of this bill.

Another example of arbitrary treatment is revealed when we examine available market data. It leaves no doubt that retailing through refiner-operated units is a marketing method practiced more by small and medium-sized refiners than so-called big oil.

It is a strategy employed by only a few of the 40 largest refiners.

Between 1972 and 1978, DOE data shows that total gallonage sold by refiner-operated units increased 6.9 billion gallons. However, 20 of these 40 largest refiners accounted for 97 percent of the increase.

Less than half of these 20 refiners are included in the bill. The others would not be forced to divorce their retail units.

The second area of major concern we have about the bill is that divorcement provisions are essentially regional rather than national in scope.

The DOE title III study found that the market share increase for all refiner-operated outlets averaged only about 4 percent nationwide for the period 1972 through 1978.

In 24 States, market share of such outlets increased less than 2 percent, or actually declined.

Today, about half, 7,700, of all refiner-operated retail outlets are concentrated in only six States—Illinois, Indiana, Michigan, Ohio, Pennsylvania, and Wisconsin.

This bill would thus have a heavy regional impact in these States and little or no impact in most other States.

We think it is especially important for this committee to realize that all the legislatures of these most heavily impacted States have considered divorcement proposals since 1979.

After extensive hearings, the proposed legislation was rejected in all those States.

The bill would impose a Federal mandate overriding the will of the legislatures of these States in what they regard as their public interest.

Divorcement legislation has been considered by 28 State legislatures since 1979 and has been rejected in all but 2.

This is strong evidence that divorcement proponents are unable to substantiate their accusations.

In conclusion, we feel the committee ought to examine the entire record. The fact that there has been a decline in the number of service stations—even the dramatic decline experienced in the early seventies—does not lead to the conclusion that refiner-operated stations were the cause of that decline.

Thank you.

Senator GRASSLEY. Thank you, Mr. Nicholson.

I have two questions I want to ask you.

On what facts do you base your statement that your company-operated stations do not compete with your branded dealers?

Are any of the stations located in close proximity to each other?

Mr. NICHOLSON. They are in the same marketplace, but they are not in the same segment of the market.

As many people do, I trade at a full service station. I am not interested in trading at a stop and go self-serve station.

Our full service stations compete in that segment of the gasoline market that is interested in full service.

Our subsidiary brands operate in another segment of the market—those people who are interested in serving themselves.

Senator GRASSLEY. What services do you provide to your different classes of customers that you feel justify Marathon's price differential?

Mr. NICHOLSON. As I outlined in my testimony, we charge more than our wholesale price to our Marathon branded customers.

That extra amount we charge is for our advertising, our Marathon brand name, and our credit cards and the fact that we have a different and better gasoline that we provide to any other customer. All of these services and the services of our salesmen and the training that we give dealers goes into the differential that we charge.

Senator GRASSLEY. Ms. Tiffany?

Ms. TIFFANY. Mr. Nicholson, are any of your salaried stations selling at retail prices below the wholesale prices being charged to your dealers?

Mr. NICHOLSON. I think you have to be very careful to remember that there are no Marathon brand company-operated stations. Therefore, for the Marathon brand that the consumer sees, there are no company-operated stations. Therefore, no company-operated stations are selling at a price less than we charge the dealer because there are none by definition.

The stations that we operate with our own employees have different brand names.

Ms. TIFFANY. Is that a phenomenon occurring at those stations that are operated under different brand names?

Mr. NICHOLSON. The different brand name stations we have compete in the same market that Mr. Pester's stations would compete in if they were in our same market area.

They are competing for the people who want self-service. They offer no credit. They do not accept Marathon credit cards. They have not the same gasoline but a different gasoline. There is no advertising. Therefore, it is conceivable that they could, because of competitive conditions, be charging a different price than a Marathon branded dealer buys for a different product with different services.

You are comparing apples and oranges when you compare the gasoline and all of the attendant services that go with it at a subsidiary brand station with the gasoline and all the subsidiary services that go with it at a Marathon brand gasoline.

Ms. TIFFANY. I am not comparing the retail prices. What I am asking is whether the retail price at the unbranded Marathon station might ever be below the wholesale price that Marathon is charging to its distributors.

Mr. NICHOLSON. And I thought I responded to that by saying that it is possible that could happen, but it is comparing apples and oranges because the gasoline being sold to that Marathon dealer who may be paying more than others are charged in this other segment of the market is different. Not only that but all the services that go along with it—the credit cards, and so forth.

You are not comparing a similar situation of the same brand name with the same gasoline with all the same attendant services at our company-operated stations as you are comparing with a dealer-operated station. You are not comparing the same thing. That is why the prices are different.

Senator GRASSLEY. Mr. Nicholson, we thank you for your testimony.

Mr. NICHOLSON. Thank you.

Senator GRASSLEY. For all the witnesses, I want to suggest that there may be written questions that will be submitted to you by members of the committee who were not able to be here this afternoon.

We want to thank all the people in the audience who were so attentive.

The hearing is adjourned.

[Whereupon, at 2:45 p.m., the committee recessed, to reconvene subject to call of the Chair.]

[Material follows:]

PREPARED STATEMENT OF G. NORMAN NICHOLSON

I am G. Norman Nicholson, Vice President, Marketing, Marathon Oil Company. I appreciate this opportunity to appear before the Committee and express Marathon's views on S. 326. I ask that my entire statement be included as part of the record of this proceeding and in the interests of time, will summarize our views.

At the outset, I would state that Marathon opposes S. 326 in its entirety. We are convinced that the wholesale transfer price, open supply and other restrictive provisions mandated by the bill will produce vastly more harm than good, particularly for the consumer. The Committee has already heard testimony on these provisions, and my comments will be directed to the divorcement provisions of the bill and their impact on Marathon Oil Company.

Marathon is a medium-sized integrated oil company engaged in exploration, production, transportation, refining and marketing of petroleum and petroleum products. Headquartered in Ohio since 1887, Marathon markets primarily in six Great Lakes States and in the southeastern area of the country.

For many years, the bulk of Marathon's gasoline has been sold to independent marketers who resell the product under their own private brand names and to independent dealers, jobbers and distributors who resell the product under the Marathon trademark. In 1980, more than 73 percent of our sales of almost four billion gallons of gasoline were made to those independent businessmen. Included in that group are the approximately 2,050 Marathon branded outlets in Indiana, Illinois, Kentucky, Michigan, Ohio and Wisconsin, which are operated by independent marketers, and which are primarily full-service stations.

The remaining 26 percent of our gasoline is sold through a wholly-owned subsidiary engaged in direct retailing under secondary brand names--Bonded, Gastown, and Speedway. The subsidiary operates approximately 735 of these secondary brand outlets which are primarily "gas and go." It is this latter group of stations which would be directly affected by the divorcement provisions of S. 326.

Direct retailing did not become a part of Marathon's marketing strategy until the early 1970s. It was dictated by two major changes in consumers' buying patterns. You will remember that prior to the Arab Embargo in 1973 most motorists bought their gasoline at major-brand full-service stations. A few traded at price discount outlets where little or no service was given, but these outlets captured a relatively minor share of the market. Motorists also purchased a large share of their car repairs and accessories at these full-service stations.

But beginning with the Arab Embargo and the subsequent quadrupling of oil prices the segmentation in the gasoline market became increasingly more pronounced. More and more motorists shifted away from the dealer-run full-service stations with their higher prices in search of gasoline-only outlets offering the lowest price. At the same time, motorists were also shifting a large part of their car repair and accessories business to specialty stores such as Midas muffler shops, Goodyear tire stores and Sears auto repair shops which offered time and cost advantages to customers for the highly specialized services they performed. By 1979 there were 53,000 of these specialty stores doing $8 billion worth of business annually. The damage which specialty stores did to full-service stations was severe because the latter normally do not survive on gasoline sales alone. Dealers operating successful full-service stations usually depend on car repairs and TBA sales for a substantial part of their revenue and often a disproportionate share of their profit.

These dramatic changes in consumer buying habits soon became evident to Marathon. Many, though not all, of our dealers lost gallonage, backroom trade and TBA sales. An unprecedented number failed, forcing us to close units in which we had large investments. At the same time, our wholesale sales to unbranded discount marketers and other evidence left no doubt that they were picking up customers our dealers were losing. In short, our experience paralleled data later developed by the DOE in its Title III study which showed that dealers lost five percentage points (5.5 billion gallons) in total gasoline market share between 1972 and 1980, while jobbers were increasing their retail sales by thirteen percentage points representing 18 billion gallons annually.

Consumers were telling us in the marketplace how and where they intended to buy gasoline. Price conscious consumers, who were a minor market segment at the beginning of the Seventies, had become the dominant segment by 1976 accounting for about 60 percent of the gasoline retail trade. The message for Marathon and other similarly situated small and medium-sized refiner-marketers was unmistakable. Adapt and respond to the changing consumer buying preferences or face a declining and potentially unprofitable marketing business. Marathon did respond by creating a viable direct-marketing retail network of about 735 outlets to serve those consumers for whom price is the dominant consideration in buying gasoline. By satisfying those customers' needs, we have preserved for Marathon a one billion gallon share of the annual gasoline retail market which otherwise would have been lost by Marathon and its dealers to other competitors.

The change in Marathon's marketing strategy which I have just outlined was necessary to retain business. It certainly was not tainted by any ulterior motive to run our dealers out of business as proponents of S.326 would lead you to believe. We recognize that an important segment of motorists -- about 40 percent -- are service rather than cost conscious consumers. These consumers, whose numbers have been relatively stable since 1976, will patronize full-service stations because they are willing to pay a little more to get the added value in products and service dealers offer in that kind of outlet. Marathon's marketing strategy is designed to serve both types of consumers through different kinds of outlets specifically catering to their respective needs.

As I stated previously, there are approximately 2,050 Marathon brand stations. These are all operated by independent businessmen--jobbers, distributors, and dealers. There are no company-operated Marathon brand stations. These are almost entirely full-service stations. They receive the value of the Marathon brand name, advertising, credit cards, dealer training and all of the other services attendant to a Marathon branded station. Even the gasolines they sell are different from those sold to our subsidiary and unbranded customers. These gasolines are of higher quality, containing additives designed to clean and reduce deposit buildup in intake systems, prevent rust formation in vehicle fuel tanks and assure better fuel economy--and they are advertised as such by Marathon. It is this type of branded station which we believe will appeal to those consumers who are looking for added value in products and service and are willing to pay a little extra for it.

In marked contrast, the 735 units operated by our subsidiary under secondary brand names are high volume, low margin stations which are designed to appeal to those consumers who are interested only in price... and low price is what they get. These "no-frills" units are almost exclusively "gas and go", self-service operations which offer no repair service or accessories, do not take Marathon credit cards, and the only advertising is the posted street price.

We do not believe that our company-operated stations compete with our branded dealers for the same customers. Rather we are convinced that each occupies an entirely different segment of the market place and each competes with other marketers offering similar services. If we were in fact trying to get rid of dealers as has been charged, Marathon's marketing data would look strikingly different from what they do. There has been little change in the number of Marathon branded stations since 1976. We have negotiated 238 new dealer leases since the beginning of 1977, not including renewals, and we are currently seeking dealers for 49 locations. We recently took over a group of dealers dropped by a major supplier. On the other side of the coin, our subsidiary actually operated more retail units in 1976 than it does today. Between 1976 and 1980 the volumes of our gasoline sold to independent businessmen versus those directly retailed through company-operated outlets have varied annually only within a narrow range of 2.5 percentage points of our total gasoline sold. We have no strategy to get rid of dealers. We have no strategy to take over their market segment with company operations. And these figures prove that point, notwithstanding the unfounded allegations which others have made. Let me say it again for emphasis. Independent dealers are extremely important to Marathon. They are a large part of our marketing strategy. Their success is our success and their failure is our failure--a failure which includes not just a loss of gasoline sales but which also jeopardizes our investment in station property whose value commonly runs several hundred thousand dollars per unit.

I have now explained Marathon's view of the gasoline and related markets. How and why they have changed, and our responsive strategy to adapt to those changes. Let me next deal with those allegations of market misconduct which clearly have fueled this legislative proposal. The primary complaints of proponents of S. 326 fall under the headings of "predatory pricing" and "predatory costing." Predatory pricing as applied to a refiner-operated retail outlet is, quite simply, selling gasoline at a price below its cost with intent to injure competitors. Such pricing practice is a direct violation of federal antitrust laws as well as those of many states. Adequate remedies for such misconduct already exist in the form of criminal sanctions and private treble damage actions. The structural remedies of S. 326 are not needed for pricing abuses of this kind. Indeed, such broad structural restraints are especially inappropriate and undesirable to remedy abuses which are by their nature products of individual decisions and separate actions.

I am familiar with the criticism that has been leveled at the DOE Title III Study from some quarters. But the fact is that it is the most thorough and objective investigation that has ever been made of marketing practices and the structure of the gasoline market. Those persons making predatory pricing accusations were afforded ample opportunity in hours of hearings and unlimited written comments to prove their claims. The DOE also subpoened the records of accused firms for all information relevant to such claims. After evaluating the evidence, the DOE concluded there was nothing to substantiate the predatory pricing changes. It even concluded that in markets like gasoline retailing predatory pricing would be an unproductive and self-defeating strategy because a predator could not hope to recoup today's losses with tomorrow's gains. Entry was too easy, and there were too many strong competitors for this to be an effective strategy. The DOE also found the gasoline market to be workably competitive at all levels and in need of no structural remedies. After review of the mountains of evidence accumulated by DOE, the FTC and the Department of Justice concurred in DOE's conclusions and recommendations to Congress.

There is one final point to be made about predatory pricing. A predator's below-cost selling adversely affects the business of all those in competition with him--dealers, jobbers and others. If predatory pricing were a widespread practice as claimed, it is inconceivable that jobbers could be gaining significant market share in the face of such marketing practices while dealers were losing market share. Yet jobbers did gain 13 percentage points of the total gasoline market between 1972 and 1980 while dealers were losing 5 percentage points and refiner-marketers were gaining only 4 percentage points.

Predatory costing is a creative label chosen by proponents of S. 326 to charge that they have been unfairly handicapped in the competitive race by unreasonable rents on station leases and by unreasonable gasoline buying prices. I am not in a position to defend every refiners' rental policies. There may be isolated cases of legitimate complaint. It is common knowledge, though, that property values have risen dramatically with inflation and the cost of everything else. To protect investment values, rents must rise accordingly or they provide inadequate returns. Dealers have no vested right in rents frozen at yesterday's values. In Marathon's case our average station rent today is slightly above $700 per month. This represents about a 6 percent annual return on property valuation. It was not until 1978, after 95 percent of the decline in station population had occurred, that we increased rents. I might add that rents paid by our subsidiary for its stations are higher than those paid by our dealers.

The second aspect of the "predatory costing" charge is that dealers are forced to start off at a competitive disadvantage because the Dealer Tankwagon price they pay is higher than the rack price of gasoline paid by their unbranded competitors. The truth is that the wholesale rack price for unbranded gasoline is lower than the Dealer Tankwagon price. But to compare the two is like comparing apples and oranges. The rack price is the commodity price of gasoline only at the rack. The DTW price is the price of gasoline delivered from the rack to the dealer's station enhanced by the value of trademark and credit card usage and a bundle of branding services which supports and benefits the dealer. In Marathon's case, as I pointed out earlier, our branded dealers, jobbers and distributors even receive different and better gasolines than do our unbranded customers and subsidiary stations. We believe the price differential between the branded gasoline package and unbranded gasoline only fairly approximates the value difference between the two. Marathon's subsidiary, incidentially, is treated exactly like any other wholesale customer who purchases unbranded gasoline at the rack and it pays the same price.

Dealers' associations have also asserted that the competitiveness of dealers has been burdened unreasonably by other provisions in their station leases. The requirement in some leases to remain open 24 hours a day is often cited as one of these unfair burdens. Marathon has never, to my knowledge, had such a clause in its dealer leases. But the short answer to most dealer lease problems is that they were dealt with comprehensively in 1978 with the enactment of the Petroleum Marketing Practices Act which expanded dealers' rights very significantly. That Act expressly prohibits ousting a dealer in order to convert a unit to a company operation.

We asked to testify at this hearing because we doubt that the members of this Committee fully appreciate the damage S. 326 could inflict. In

Marathon's case the approximately 735 units operated by our subsidiary are valued at substantially in excess of $200 million. They employ about 4,000 people and serve customers who buy about one billion gallons of gasoline annually. It is impractical to convert these units to dealer operation. Divorcement, therefore, would almost certainly equate to divestiture which would jeopardize the jobs of the 4,000 employees and devalue the investment for our 43,000 shareholders. With one billion gallons of gasoline potentially searching for a home, both our refining and marketing operations would be severely threatened. The forced sale of these units to other refiners who are excluded from divorcement, or jobbers, or chain marketers would virtually assure that they would continue to be operated through employees as high-volume, low-margin outlets. This would be a financial bonanza for the buyers, but it would do nothing to ease the plight that dealers allege they are experiencing. When you realize that Marathon represents less than 10 percent of the outlets that would be affected by the divorcement provisions of S. 326, you begin to understand the magnitude and dimensions of the damage that S. 326 would inflict on the gasoline marketplace. They are staggering.

The divorcement provisions extend even further than this for affected refiners. They would also reach such a refiner's investment interest in affiliated, non-controlled marketing companies. If such a refiner owns the "single largest share" of the stock of another corporation which operates retail gasoline stations, such corporation will be deemed to be a "related person" and prohibited from continuing direct operation of its retail stations. It does not matter whether the refiner's interest is active or simply a passive investment. It does not even matter whether the refiner does or can legally, either through a majority stock position, contract or otherwise, control the operations of the affiliated corporation. All that matters is that the refiner owns the "single largest share" of stock.

The Committee should clearly understand that this legislation does not prohibit all refiners from operating retail gasoline stations. Only 16 of the more than 150 refiners in the United States will be so prohibited. The 16 refiners forced into divorcement under the bill are not even the 16 largest refiners--the 13th, 17th and 18th largest refiners are excluded while the 19th is included.

There are between 14,000 and 15,000 gasoline retail outlets operated by refiners, but S. 326 would only affect approximately 8,000 of these existing outlets.

There is utterly no rhyme or reason to the selection of these particular sixteen refiners for application of the divorcement provisions of S. 326. The group of sixteen does not include all those refiners identified with gasoline retailing through company-operated stations. Only a few of the sixteen condemned refiners have any significant number of company-operated retail units. The sixteen have not been singled out on the basis of some form of alleged--much less proven--market misconduct that they peculiarly have perpetrated.

The 16 refiners subject to divorcement were arbitrarily selected by exempting from the purview of S. 326 all "small" and "independent" refiners as defined by the much criticized and now inoperative Emergency Petroleum Allocation Act of 1973, which was passed to comprehensively regulate crude oil prices and supplies, and petroleum prices and distribution. The refiner definitions in EPAA were arbitrary and they were inconsistent with more rational and longer-standing federal policies embodied in the Internal Revenue Code and Small Business Administration regulations, both of which define an "independent" or "small" refiner generally as one which has a throughput capacity of less than 50,000 barrels per day, without regard to the source of its crude oil. The stated purpose of S.326, like that of the IRC and SBA regulations, is to assist small business, not to allocate crude oil as was the purpose of EPAA. We raise this issue not to argue for a more expansive divorcement provision--we think divorcement is wrong in any form--but rather to point out the arbitrary, inconsistent and illogical nature of this bill.

Available market structure data leave no doubt that retailing through refiner-operated units is a marketing method practiced far more by small and medium-sized refiners than "Big Oil." It is a strategy employed only by a few of the 40 largest refiners, and is far from a universal practice. Between 1972 and 1978, DOE data show the total gallonage sold by refiner-operated units increased 6.9 billion gallons. Twenty of the 40 largest refiners accounted for 6.7 billion gallons (or 96.6 percent) of this increase. Less than half of those 20 refiners would be forced to divorce their retail units under S. 326. Conspicuously absent from this "growth" list, but divorcement victims nevertheless, are Exxon, Standard Oil of California, Standard Oil of Indiana, Shell, Texaco, Phillips and Getty.[1] S. 326 is patently discriminatory and arbitrary in applying its divorcement provisions in this willy-nilly fashion.

The object of S. 326 is to improve the competitive position of dealers. The most cogent argument that can be made against it, perhaps, is that it will not and cannot achieve its objective. It will leave untouched about half of the 14,000 to 15,000 outlets currently operated by refiners. Many of the exempt refiners are among the most aggressive in direct gasoline retailing. Jobbers, whose share of the gasoline retail market grew three times faster than that of refiner-marketers between 1972 and 1980, are left untouched by divorcement. These groups together with chain retailers and convenience stores will continue to serve the price conscious motorist. At most, S. 326 will eliminate 16 refiners from gasoline retailing. Most of these already have an insignificant number of company-operated retail units. The remainder will be forced to sell their high-volume, low-margin outlets to other similar type retailers who are exempt from the divorcement provisions of S. 326. In any case, the trade enjoyed by the affected outlets of the divorced refiners will surely be taken over by other discount marketers, not dealers.

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[1] *The State of Competition in Gasoline Marketing,* U.S. Department of Energy, January 1981, Table 4-4.

Finally, this Committee should recognize that the problems which S. 326 attempts to address with its divorcement provisions are essentially regional rather than national in scope. A national remedy for these regional problems is neither desirable nor necessary. The DOE Title III study found that the market share increase for all refiner-operated retail outlets averaged only about 4 percent nationwide for the period from 1972 through 1978. In 24 states, the market share attracted by such outlets increased less than 2 percent or actually declined.[2/] Today, in fact, about half (7,700) of all refiner-operated retail outlets are concentrated in only six states: Illinois, Indiana, Michigan, Ohio, Pennsylvania and Wisconsin. This is the territory primarily where the most aggressive refiner-marketers operate. S. 326 would have a distinctly heavy regional impact in these states, and little or no impact in most other states. It is especially important for this Committee to realize that all of the legislatures of these most heavily impacted states have considered divorcement proposals since 1979. After extensive hearings, the proposed legislation was soundly defeated in them all. The enactment of S. 326 would be tantamount to imposing a federal mandate overriding the will of the legislatures of these states and what they regard to be in their best public interest. As a matter of fact, divorcement legislation has been considered by 28 state legislatures since 1979. It died or was rejected in all but two. Only Connecticut and Virginia passed any legislation on the subject, and the Virginia bill did not compel any actual divorcement. This is strong evidence that divorcement proponents have been unable to substantiate their accusations in state legislatures, and that no compelling case for divorcement exists.

In conclusion, Marathon asks the Committee to examine the entire record. The fact that there has been a decline in the total number of service stations, even the dramatic decline experienced in the early

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[2/] The states were: New Mexico, California, Alabama, Massachusetts, Delaware, New Hampshire, Mississippi, Connecticut, Nevada, Alaska, Colorado, Arkansas, Utah, Maine, South Dakota, South Carolina, North Dakota, Vermont, Hawaii, North Carolina, Wyoming, Washington, Oregon and Montana.

1970's, does not lead to the conclusion that refiner-operated stations were the cause of that decline, or that the prohibition of some or all of them is the cure for the future.

We have tried to point out that there are definite reasons for the changes that have occurred in the gasoline market place in recent years; that the market system is working--the market is delivering the services that consumers demand at the lowest possible price; that this legislation could be economically devastating to medium sized companies such as Marathon; that this legislation would be ineffective in solving the problems of the dealers at best, and at worst, could lead to greater market concentrations thus reducing the very competition the bill was intended to promote; and finally, that the states most impacted by this situation have considered divorcement and rejected it as a solution. It must be evident that the elimination of some suppliers and some low-price marketers cannot promote or enhance competition. Divorcement blatantly aims to protect a special class of competitors at the expense of other competitors and competition itself. This is not to say that competition would be destroyed by such action, but it certainly would be diminished. And it is the consumer and the public interest which ultimately pay the costs of reduced competition. Such costs would come in the form of diminished purchasing options and higher prices.

For all these reasons, I urge you to reject S. 326.

Thank you. I will be happy to answer any questions you have.

APPENDIX

STROM THURMOND, S.C., CHAIRMAN
CHARLES McC. MATHIAS, JR., MD.
PAUL LAXALT, NEV.
ORRIN G. HATCH, UTAH
ROBERT DOLE, KANS.
ALAN K. SIMPSON, WYO.
JOHN EAST, N.C.
CHARLES E. GRASSLEY, IOWA
JEREMIAH DENTON, ALA.
ARLEN SPECTER, PA.
JOSEPH R. BIDEN, JR., DEL.
EDWARD M. KENNEDY, MASS.
ROBERT C. BYRD, W. VA.
HOWARD M. METZENBAUM, OHIO
DENNIS DeCONCINI, ARIZ.
PATRICK J. LEAHY, VT.
MAX BAUCUS, MONT.
HOWELL HEFLIN, ALA.
VINTON DEVANE LIDE, CHIEF COUNSEL
QUENTIN CROMMELIN, JR., STAFF DIRECTOR

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, D.C. 20510

October 26, 1981

Mr. William J. Bittles, Jr.
Vice President of Retail Sales
Shell Oil
Houston, Texas

Dear Mr. Bittles:

Attached are questions regarding S. 326 that Senator Laxalt would like you to answer. Please respond in writing within seven days so that your answer may be included in the printed record of the July 30th hearing.

With best wishes and kindest regards,

Sincerely,

Strom Thurmond
Strom Thurmond

QUESTIONS FOR SHELL OIL CO.

1. Do the open supply provisions of S. 326 comply with:

- Trademark protection requirements?
- Local consumer protection laws?
- Truth in advertising laws?
- Octane posting requirements?
- Petroleum Marketing Practices Act provisions making misbranding, adulteration or trademark violations grounds for termination of dealership?

2. Do you find existing anti-trust laws -- such as the Sherman Act and Robinson-Patman Act -- adequate to deal with the subsidization charges aimed at refiners which this bill purports to alleviate?

SENATOR LAXALT

Shell Oil Company

One Shell Plaza
P. O. Box 2463
Houston, Texas 77001

W. J. Bittles, Jr.
Vice President Retail Sales

November 3, 1981

The Honorable Strom Thurmond
United States Senate
Washington, D.C. 20510

Dear Senator Thurmond:

Thank you very much for your inquiry concerning my testimony at the hearing. The answers to the questions raised are as follows:

You first asked whether the open supply provision of S. 326 complied with various specified laws and legal requirements. As you know, the essence of the open supply provision is that it prevents refiners from prohibiting their branded retailers from purchasing product from another except under circumstances where the refiner/purchaser contract has an exclusive provision which is applicable only when the refiner has supply available. The open supply provision also requires that retailers provide reasonable notice at the point of sale to motorists that the gasoline being sold was not refined by the branded refiner involved.

Our major concerns, as outlined in my written statement to the committee are:

- o A motorist pulling into a Shell station expects to purchase Shell gasoline, with the product and performance characteristics and consistency associated with our brand. None of this could be assured under an "open supply" situation as prescribed in S. 326.
- o We will experience additional costs to protect our trademark rights under the federal Lanham Act and various state laws. The consumer will ultimately bear those costs.
- o The consumer has the right to be protected from deception, mistake or confusion, but with "open supply" as proposed in S. 326 there would be an increased chance of product adulteration or commingling.
- o In the event of a product quality problem the consumer would have difficulty identifying the culpable manufacturer.
- o Increased variations from environmental standards could take place. If lead is found in unleaded gasoline, responsibility could be difficult and perhaps impossible to ascertain.
- o Oil company incentive to invest in maintenance of existing stations, or to build new ones, could be destroyed if widespread unbranding took place.
- o IN SUMMARY, OUR MAJOR CONCERN IS THAT THE OPEN SUPPLY PROVISION COULD LEAD TO WIDESPREAD MARKETING OF SEVERAL BRANDS OF GASOLINE - PERHAPS COMMINGLED AT ONE SERVICE STATION - AND THAT SUCH A PRACTICE WOULD RESULT IN SUBSTANTIAL CONFUSION, UNCERTAINTY AND PERHAPS DECEPTION TO THE MOTORING PUBLIC.

With regard to the specific requirements mentioned in your letter, we believe that the trademark protection requirements under the Lanham Act are not complied with by the open supply provision in S. 326. We believe such is the case because the Lanham Act, in essence, requires that a seller take sufficient steps in identifying the source of his product so as to avoid the likelihood of confusion by prospective buyers. We cannot say with any degree of certainty whether the requirements for "reasonable notice" in Section 2(c)(2) of S. 326 would be sufficient to avoid confusion. As an example I attach a copy of a letter which we recently received. The letter is from a Shell customer who was quite upset at having gone into a Shell station only to find the dealer was selling non-Shell gasoline. Despite the fact that there was a small sign on the pump dispenser, the motorist stated that he was confused and would not have gone into the service station had he realized that gasoline being sold was not manufactured by Shell. Moreover, the customer informed us that he would not patronize that particular station again, and in fact, wouldn't buy at any other Shell stations either. We are presently in contact with that customer seeking to keep his business. I noted in my oral testimony before the committee, we took a small sample at a station where one pump was debranded and found that 30 out of 40 people who purchased gasoline from that pump thought they were buying Shell product. We realize that these examples are of limited scope but my experience suggests that they are probably representative and that we would therefore have a Lanham Act/trademark problem if S. 326 passed as written.

You next asked about the effect of the open supply provisions on local consumer protection and truth in advertising laws. We strongly believe that S. 326 creates the potential of widespread mixing of products either through the sale of products manufactured by more than one refiner at branded stations or through the commingling of product. This mixing of products would create confusion among a vast number of motorists. Shell customers, when in need of gasoline, usually look for identifying marks and signs at a service station location. While we are not prepared to say that the sale of non-Shell gasoline at a Shell station would create confusion under all circumstances, we believe that it likely would. Furthermore, we do not believe that even the removal of all identifications would necessarily be the solution especially if the Shell dealer is selling Shell gasoline as well as non-Shell gasoline. Moreover, with regard to truth in advertising we feel that there may be significant limitations on the kinds of advertising that a dealer may have if the dealer is selling non-Shell gasoline. For example, if the dealer wishes to promote Shell motor oil through an advertisement in which the address of his station is to be listed and such dealer was selling non-Shell gasoline, his advertisement might be deemed as being deceptive in that he was using the Shell brand in a promotion to draw customers into his station who likely would expect to purchase Shell gasoline there too.

You next asked about octane posting requirements. We believe that there will be significant difficulty in dealers complying with the octane posting requirements if a large number of dealers purchase gasoline from several suppliers. Each dealer can be reasonably assured of the octane level and quality of the gasoline it receives from its branded refiner supplier and, therefore, would have little difficulty complying with the octane posting requirements if the product in the tank was wholly supplied by the dealer's branded refiner. However, if the dealer receives and commingles gasoline differing octanes from different suppliers, he will need to post an octane level which consists of the weighted average of the octane levels of the gasolines in his underground tanks. This weighted average would change every time gasoline of an octane level different from such average is added to the tank. Even if a dealer chose to buy one or more products exclusively from a different supplier, unless his tanks were purged, there would be commingling necessitating the averaging of octanes to arrive at the proper figure for posting.

You next asked about the Petroleum Marketing Practices Act provisions which provides that adulteration, mislabeling, misbranding or other trademark violations are grounds for termination. We believe the Petroleum Marketing Practices Act provisions would still remain in effect, but might be subject to modification in its interpretation on account of Section 2(c)(2) if the standard under the Lanham Act is so changed by such section. Moreover, increased terminations and abuses as well as litigation could occur.

As you can see from the foregoing comments, we strongly believe that the major problems will not necessarily be with regard to the other laws, but will exist because of the confusion and uncertainty which will occur in the marketplace. A major significant concern of ours is that dissatisfied motorists may have nowhere to turn because the source of their "problem gasoline" could not be determined. Moreover, we believe that the open supply provision is absolutely unnecessary because there currently exists a significant unbranded independent retail market throughout the country. Thus, motorists have a clear choice. We believe that if a motorist drives into a Shell station, he likely believes and should be entitled to believe that the gasoline there was manufactured by Shell or made by others to our specifications and that Shell Oil Company stands behind the gasoline's quality. If the motorist wishes to buy another brand of gasoline or unbranded gasoline, the motorist need merely pull into another service station.

One final point. Shell will not be motivated to build new stations at a cost of $400,000 to $600,000 each for the purpose of selling Exxon (or some other) gasoline. We employ real estate, engineering and sales expertise to locate, construct and help merchandise our stations and train our dealers. We maintain, at our expense, over 100,000 pumps, tanks, dispensers and consoles dedicated to gasoline sales, and we make a very expensive credit card system available to dealers and consumers. To expect us to continue these practices for the benefit of our competitors is unrealistic.

Your second question dealt with whether the existing antitrust laws are adequate to deal with subsidization charges aimed at refiners. You are obviously referring to the divorcement provision in the legislation which would require major refiners (but not jobbers or chain marketers) to give up ownership of service stations. Title III of PMPA clearly shows that there has not been any massive subsidization by the oil industry and that the marketing segments of integrated oil companies is standing on its own. The existing laws fully and adequately protect against subsidization, sales below cost, and predatory pricing. Clearly if the dealers feel there is a problem, a ban on major refiner salaried operations would not be a cure. Much more often the independent/small refiner's, jobber's or chain marketer's salaried stations, not covered by S. 326, are the dealers' most significant competitors.

With regard to existing laws, it should be noted that refiners or jobbers engaging in a predatory pricing scheme are in violation of several federal antitrust statutes, most notably Section 2 of the Sherman Act which generally makes illegal any attempt to monopolize trade or commerce in the United States. The Supreme Court has ruled that Section 2's prohibition includes a firm lowering of its prices for the purpose of driving out its rivals and obtaining a monopoly. If several firms combine to drive out a competitor, then Section 1 of the Sherman Act is applicable. Section 1 prohibits combinations or conspiracies in restraint of trade, including territorial agreements and refusals to supply. The Sherman Act, then, would seem to apply to the predatory allegations heard by your committee. The federal antitrust laws have several advantages as remedies for predation. First, the injured parties are compensated for their losses; the Sherman Act also provides for trebling the actual damages sustained by a plaintiff. Second, future anticompetitive conduct is deterred by the liability for treble damages and by the possibility of a felony prosecution. The third advantage of using the current antitrust remedies is that they are narrowly focused on the anticompetitive conduct. In addition to the antitrust laws, PMPA has some provisions which expressly prohibit termination or nonrenewal of a dealer for the purpose of converting to a salary operation.

We certainly appreciate the opportunity to provide these comments to you and as always are most willing to supplement these comments and provide any other information in which you might find germane to this subject.

Sincerely,

Attachment

DATE: 09-11-81

TO: SHELL OIL CO.
ATTENTION:

FROM:

SUBJECT: PRODUCTS SOLD UNDER THE SHELL NAME BUT NOT SHELL PRODUCTS

PER OUR PHONE CONVERSATION ON THIS DATE, I THINK IT MISLEADING AND IN VERY POOR TASTE TO ADVERTISE ONE BRAND NAME AND EVEN HOUSE IT IN A CONTAINER WITH YOUR NAME ON IT AND THEN PUT A DISCLAIMER ON IT, IN ORDER TO SELL THE UNKNOWN PRODUCT TO THE PUBLIC.

I CAN ASSURE YOU THAT I DON'T INTEND TO STOP AT ANY OF YOU STATIONS FROM NOW OWN UNTIL I CAN BE ASSURED THAT I WILL BE BUYING A PRODUCT BELONGING TO YOU. I DON'T KNOW HOW MANY PEOPLE FEEL THIS WAY BUT I DON'T THINK I AM THAT MUCH OF A WEIRDO. I CAN ALSO ASSURE YOU THAT I WILL NEVER USE THE SHELL STATION ON OATS DRIVE AGAIN EITHER. THERE ARE A LOT OF OTHER THINGS I COULD SAY ABOUT THIS; BUT I THINK YOU GET THE POINT.

SINCERELY,

NOTE: The name of the Shell customer signing this letter has been removed. It may be furnished upon request.

STROM THURMOND, S.C., CHAIRMAN
CHARLES McC. MATHIAS, JR., MD.
PAUL LAXALT, NEV.
ORRIN G. HATCH, UTAH
ROBERT DOLE, KANS.
ALAN K. SIMPSON, WYO.
JOHN EAST, N.C.
CHARLES E. GRASSLEY, IOWA
JEREMIAH DENTON, ALA.
ARLEN SPECTER, PA.
JOSEPH R. BIDEN, JR., DEL.
EDWARD M. KENNEDY, MASS.
ROBERT C. BYRD, W. VA.
HOWARD M. METZENBAUM, OHIO
DENNIS DeCONCINI, ARIZ.
PATRICK J. LEAHY, VT.
MAX BAUCUS, MONT.
HOWELL HEFLIN, ALA.
VINTON DEVANE LIDE, CHIEF COUNSEL
QUENTIN CROMMELIN, JR., STAFF DIRECTOR

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, D.C. 20510

October 26, 1981

Honorable Michael Cardenas
Administrator
Small Business Administration
1441 L Street, N.W.
Room 1000
Washington, D.C. 20416

Dear Mr. Cardenas:

Attached are questions regarding S. 326, the "Small Business Motor Fuel Marketer Preservation Act of 1981" that Senators Laxalt, Hatch, Simpson and East would like you to answer. Please respond in writing as expeditiously as possible so that the mark-up on this legislation will not be unduly delayed.

With best wishes and kindest regards,

Sincerely,

Strom Thurmond
Strom Thurmond

Senators Laxalt, Hatch, Simpson and East

The Committee on the Judiciary has under consideration S. 326, the Small Business Motor Fuel Marketer Preservation Act, a bill that would require the divorcement of motor fuel service stations from operation by certain refiners. A companion measure, H.R. 1362, has been introduced in the House of Representatives.

The House bill contains a provision which would authorize the Small Business Administration to guarantee real estate mortgages for the purchase of motor fuel service stations. This would be a departure from the current congressional policy that precludes SBA loans that are primarily for the purchase of real estate. If legislation is enacted containing the loan guarantee provisions of H.R. 1362, it potentially could involve guarantees for virtually thousands of mortgages for retail outlets scattered throughout the United States. Between 1972 and 1979 the statistics show that dealer-operated motor fuel retail outlets have declined from 211,000 to 136,000, indicating a substantial rate of failure.

In anticipation that H.R. 1362 may be referred to the Senate Judiciary Committee, we would appreciate your views on (i) the proposed modification of the current policy that prohibits the Administration from guaranteeing real estate mortgage loans, to precluding the United States from becoming the holder of randomly-located plots of real estate; and (ii) whether such a change is consonant with the President's announced policy of reducing the number of loan guarantee programs funded by the federal government, as such programs are administered by the Small Business Administration.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

NOV 16 1981

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This is in response to your letter of October 26, 1981, in which you request my answers to two questions which you have posed relative to S. 326, the Small Business Motor Fuel Marketer Preservation Act of 1981, and H.R. 1362, a companion measure both of which are presently before the Congress. Your letter points out that the House bill contains a provision which would authorize the Small Business Administration to guarantee real estate mortgages for the purchase of motor fuel service stations. You state that this would be a departure from the current congressional policy that precludes SBA loans that are primarily for the purchase of real estate. You state that in anticipation that H.R. 1362 may be referred to the Senate Judiciary Committee, you would appreciate the views of SBA on:

(1) the proposed modification of the current policy that prohibits SBA from guaranteeing real estate mortgage loans; and

(2) whether such a change is consonant with the President's announced policy of reducing the number of loan guarantee programs funded by the Federal Government.

Section 2 of H.R. 1362 would amend subsection 7(a) of the Small Business Act by inserting after the first sentence of that subsection a new sentence which would read:

> "Notwithstanding the proviso in the preceding sentence, the Administration may participate on a deferred basis in any loan under this section to any dealer acquiring a motor fuel service station without regard to whether such loan is primarily for the acquisition of land."

We view this provision as not contradictory to the present provisions of the Small Business Act or SBA policy and, therefore, unnecessary. Presently, subsection 7(a) of the Small Business Act merely requires that SBA guaranteed loans should not be used primarily for the acquisition of land by small homebuilders. Other acquisitions of land are not prohibited. We presently are able under subsection 7(a) to authorize the utilization of SBA financial assistance in a wide variety of areas for the purchase of real estate when that purchase is part of the business expenses associated with a noninvestment oriented business endeavor such as purchase or lease of a gas station. Therefore, the proposed amendment contained in H.R. 1362 would not be contradictory to SBA policy, is not contradictory to the present provisions of the Small Business Act, and is unnecessary.

You have also asked whether the amendment is consonant with the President's announced policy of reducing the number of loan guarantee programs funded by the Federal Government. It is our position that the loans made pursuant to this amendment if it were enacted would be made pursuant to what amounts to the already existent authority in subsection 7(a) of the Small Business Act. The number of such loans would be limited by the provisions of appropriate authorizing and appropriations legislation which presumably would be passed by the Congress and agreed to and enacted into law by the President. Therefore, loans would be wholly consistent with the policies of the Administration.

We trust that this information will be useful in your deliberations. If you have any further questions regarding this subject, please do not hesitate to contact me.

Sincerely,

Michael Cardenas
Administrator

STROM THURMOND, S.C., CHAIRMAN
CHARLES McC. MATHIAS, JR., MD.
PAUL LAXALT, NEV.
ORRIN G. HATCH, UTAH
ROBERT DOLE, KANS.
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JOHN EAST, N.C.
CHARLES E. GRASSLEY, IOWA
JEREMIAH DENTON, ALA.
ARLEN SPECTER, PA.
JOSEPH R. BIDEN, JR., DEL.
EDWARD M. KENNEDY, MASS.
ROBERT C. BYRD, W. VA.
HOWARD M. METZENBAUM, OHIO
DENNIS DeCONCINI, ARIZ.
PATRICK J. LEAHY, VT.
MAX BAUCUS, MONT.
HOWELL HEFLIN, ALA.
VINTON DeVANE LIDE, CHIEF COUNSEL
QUENTIN CROMMELIN, JR., STAFF DIRECTOR

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, D.C. 20510

October 26, 1981

Honorable James C. Miller, III
Chairman
Federal Trade Commission
Room 440
6th Street & Pennsylvania Ave., N.W.
Washington, D.C. 20580

Dear Mr. Chairman:

Attached are questions regarding S. 326, the "Small Business Motor Fuel Marketer Preservation Act of 1981" that Senators Laxalt, Hatch, Simpson and East would like you to answer. Please respond in writing as expeditiously as possible so that the mark-up on this legislation will not be unduly delayed.

With best wishes and kindest regards,

Sincerely,

Strom Thurmond
Strom Thurmond

Senators Laxalt, Hatch, Simpson and East

S. 326, a bill to require the divorcement of motor fuel service stations from operation by certain producers and refiners of motor fuel, to control sales by producers and refiners of motor fuels, and for other purposes, is presently before the Committee on the Judiciary, a panel on which we serve. The bill is designed, among other things, to preclude predatory pricing by integrated oil refiners in the sale of retail petroleum products. Allegations that such conduct exists have been the subject of inquiry by the Committee over the years.

In this regard, we are requesting your views on whether the current provisions of the Robinson-Patman Act are sufficient to cover any existing or future predatory pricing that may take place as a result of the integration of oil refining companies in the retail marketing of their products. In addition, we would appreciate your views on the impact that enactment of S. 326 would have on the orderly enforcement of the provisions of Robinson-Patman Act under the Commission's jurisdiction.

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

November 2, 1981

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I thank you on behalf of the Commission for the opportunity to present Commission comments on S.326, the "Small Business Motor Fuel Marketers Preservation Act of 1981." The Commission has reviewed the provisions of the bill, as well as the additional questions on Robinson-Patman Act enforcement in your letter of October 26, 1981. For the reasons discussed below, the Commission opposes passage of S.326 as anticompetitive.

The declared purpose of S.326 is to preserve the small, branded, motor fuel marketer. This would be achieved through divorcement by major refiners of their company operated stations, dealer rights of first refusal to purchase dealer-operated stations, price discrimination prohibitions through the application of a daily wholesale transfer price, and open supply rights for branded dealers.

The Commission shares your concern that small business firms be free from predatory behavior and unfair methods of competition. However, we believe that S.326 will not achieve that purpose, but rather may well exacerbate existing competitive pressures with which branded gasoline franchisees, as well as their suppliers, now contend because of historical changes. Our belief stems from the evolution of gasoline marketing from an era of large numbers of small-volume, high-overhead stations, to a period where high-volume, low-overhead stations will predominate.

Past inefficiencies in the gasoline marketing system endured because, in the past era of cheap, plentiful crude oil, most major, integrated oil companies were able to maintain low-volume, full service outlets at the gasoline marketing level, because of their contribution to overall corporate profitability. However, in the 1970's, the shift of power to set world crude oil prices to the OPEC cartel, structurally altered conditions which permitted the previous marketing system. The shift to low-cost, high-volume marketing, in any event, would have occurred more naturally, had government price and allocation controls not been imposed on the petroleum industry under the Emergency Petroleum Allocation Act of 1973 (EPAA).

Now that controls have been lifted, natural market forces should be permitted a fair opportunity to allocate resources in the most efficient manner. Further government controls should not be enacted to delay this necessary reordering of petroleum industry incentives. The Commission is of the opinion that such delay will only further aggravate disruption at the marketing level caused by several years of government regulation.

I would like next to discuss our opposition to specific provisions of S.326. First, the Commission is opposed to the retail divorcement provisions [§2(b)(1)].[1] In the absence of clear and convincing evidence that the forces of the marketplace have failed to allocate goods and services in an efficient manner, the market should determine the ultimate mix and character of competitors. As explained above, the Bureaus of Competition and Economics believe that present competitive pressures on dealers are a result of historical changes in the world petroleum market. Nowhere is there present evidence that the closing of small retail stations is being accomplished through concerted predation or monopoly behavior. Thus, without a predicate of contemporary predatory behavior, there appears to be no justification for barring a significant class of competitors from the marketplace. The divorcement provision would probably only preserve a less efficient distribution system, shielding it against normal, competitive forces. Someone would have to pay for these inefficiencies, and the consumer would be the likely bearer of such costs.

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[1] Because the Commision opposes divorcement, we have refrained from comment on the provisions of the bill concerning dealers' first refusal rights in purchasing retail outlets.

The Commission also opposes the daily wholesale transfer price provisions [2(b)(1)-(3)], the anti-subsidization provisions, which would require a gasoline wholesaler to sell or transfer motor fuel at a single daily price, including sales to independent wholesale purchasers or any person "related to the supplier". The basis for this provision is the premise that integrated refiners sell gasoline at high prices to franchised dealers and at low prices to company-operated stations, to drive the former group out of business. The Commission rejects this premise as unfounded. There is simply no clear evidence of this form of predatory subsidization having occurred or presently taking place.[2] Moreover, refiner compliance with such a provision would be extremely difficult, if not impossible. Consider the decisions a supplier would have to make before determining whether to sell a cargo wholesale or retail. The supplier would first have to know all costs from the point of transfer to the point of sale, for each individual cargo subject to sale, and from every transfer point where a purchase offer might be made. In order to calculate such costs, the supplier would not only have to determine constant costs but also those costs which vary with conditions. For instance, if the retail volume sold at a given station should unexpectedly drop, the supplier's unit costs might increase significantly, thereby violating the subsidization standard. If the supplier attempted to lower retail price to increase volume, per unit revenue would decline, again threatening compliance with the subsidization rule.

In contrast to a supplier's need under the proposed legislation to predict immediate future profit on each sale, accounting techniques could only provide an historical perspective over a broad range of sales for a significant period of time. Consequently, we neither believe it would be possible for a refiner to comply with the retail subsidization provision set out in this bill nor do we believe that the FTC could develop guidelines which would ensure refiner adherence to the standard. Finally, imposition of such price rigidity by the anti-subsidization provisions might intensify vertical integration by jobbers and less integrated refiners, into company-operated outlets, to avoid the difficulties the legislation would cause in meeting competition in a flexible manner.

Further, although we applaud the purpose of the "open supply" provisions of S.326 [2(c)] which is to enhance the dealer's competitive flexibility, the analysis of the Bureaus of Competition and Economics leads us to conclude that this provision of the bill will be counter-productive to that end, and may even encourage the disappearance of branded, franchisee dealers as a class of competitors. It may be true that the franchisor has a great deal of leverage over the dealer-franchisee, and this leverage can be abused, given the franchisor's ability to terminate or fail to renew a short-term franchise agreement. This may be the case notwithstanding the limited dealer protections embodied in the 1978 Petroleum Marketers Preservation Act (PMPA). However, with absence of the open supply provision the supplier-dealer relationship may continue to be an enduring one, to the extent that the arrangement is profitable to each party over the long term. Even with the competitive pressures to streamline the branded gasoline marketing system imposed by petroleum industry changes, there seems to be a decision that the system will continue in some form, now that controls have been lifted. Exxon, according to published reports, for example, has reputedly sought to assure its dealer network that the service station relationship continues to be an important component of Exxon's marketing plans. However, the imposition of open supply provisons in S.326 may create unnecessary pressures to eliminate the branded franchise dealer network altogether, if open supply is unprofitable for refiners.

As stated above, the Commission believes that competition has not been given as yet an adequate chance to work in this industry. Controls have only recently been eliminated, and the forces of the marketplace need time to accomplish their goals of efficient allocation of product to the consumer at the lowest price. Although we are concerned about the effect that marketplace changes may have on the continued existence of small gasoline retailers, there may be overriding advantages to the consumer for letting these competitive changes occur in a natural fashion. Given the enormous increase of prices for crude oil through the actions of the OPEC cartel in recent years, the lower costs of a more efficient gasoline retailing system should permit lower retail prices than would otherwise be the case with high-cost, low-volume marketing techniques.

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[2] The Department of Energy's 1981 Title III Study, while admittedly limited in scope, found no evidence of predatory subsidization.

Finally, the Commission has considered the questions of Senators Laxalt, Hatch, Simpson, and East concerning Robinson-Patman Act enforcement in your letter of October 26. The Commission has been under a Congressional mandate since 1914, to define and prevent unfair methods of competition, and to prevent monopolistic and predatory practices which threaten small business and the economy as a whole. Now that the distortional effects of government regulation of the petroleum industry have been removed, we will continue to be alert to evidence of unfair methods of competition in that industry. A significant proportion of the Commission's resources have been and will continue to be devoted to maintenance of competition in energy. We believe that enforcement of the antitrust laws, including the Robinson-Patman Act, to maintain free markets is superior to regulatory legislation, in the absence of demonstrated market failures. In this respect, the Commission believes that the price rigidity required by the anti-subsidization provisions of S.326, as discussed above, is inconsistent with the Robinson-Patman Act's requirement that "injury to competition" be proved as an essential element of a statutory violation.

On behalf of the Commission, I again thank you for the opportunity to express Commission comments on S.326.

By direction of the Commission.

James C. Miller III
Chairman

Department of Energy
Washington, D.C. 20585

November 19, 1981

Honorable Strom Thurmond
Chairman, Committee on the Judiciary
United States Senate
2226 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed are answers to the questions you submitted on October 26, 1981, to the Department of Energy on behalf of Senator Laxalt regarding S.326, the Small Business Motor Fuel Marketer Preservation Act of 1981.

We are providing you this information in follow-up to Leonard Coburn's testimony before the Judiciary Committee on October 21, 1981.

A copy of this response is also being furnished to Senator Laxalt.

If you have any questions, please call Cathy Hamilton or Tom Pretorius of my staff on 252-4277. They will be happy to assist you.

Sincerely,

Robert G. Rabben
Assistant General Counsel
for Legislation

Enclosures

cc: Senator Paul Laxalt
Ms. Marcy Tiffany

Department of Energy
Washington, D.C. 20585

November 19, 1981

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

This is in response to the questions submitted by Senator Laxalt regarding S. 326, the Small Business Motor Fuel Marketer Preservation Act of 1981. Senator Laxalt submitted seven questions which will be answered in turn.

> Question 1: Do you perceive that the divorcement and pricing provisions of S. 326 would have an adverse impact on the distribution of motor fuel?

Answer: Both provisions would have severe impacts on the marketplace by limiting competition in the distribution and marketing of motor fuel. Divorcement would limit the number of competitors and the methods of competition in the marketplace. Any restrictions on competitors in the marketplace has an adverse impact. The 16 refiners barred from direct operations will have to find alternative marketing and distribution methods if they decide to remain in the market.

The pricing provisions, by attempting to create a single wholesale daily transfer price, will affect product distribution substantially. Products presently are distributed with varying prices reflecting the various services performed by the plethora of actors in the marketplace. The pricing provisions of this bill would result in less flexible and less efficient distribution and marketing of motor fuel, thus imposing additional costs on consumers.

> Question 2: If the "open supply" provision of S. 326 were enacted, how can the supplier and retailer assure compliance with trademark protection laws, truth in advertising laws, and state and federal laws against misbranding and commingling of products?

Answer: The open supply provision creates acute problems in complying with trademark protection laws, truth in advertising laws, and state and federal laws against misbranding and commingling of products. The bill provides for a point-of-sale notice to customers when products other than the branded product are being sold. But unless the marketer establishes separate pumps for the unbranded gasoline or other fuels, commingling would be inevitable. A violation of trademark laws could occur and truth in advertising laws would be violated. Of course, it would be incumbent upon the refiner to enforce these laws against the marketer. Where appropriate, state and federal enforcement officials may have enforcement responsibilities. In either case, the open supply provision could lead to numerous enforcement actions placing a burden on the dealer, the refiner, the state and federal officials, and the courts. The consumer is the one who is left in a state of bewilderment not knowing whose product is being sold.

> Question 3: Is there any way to quantify the percentage of number of dealerships which have closed during the past ten years as a result of alleged unfair refiner competition which S. 326 and H. R. 1362 seek to alleviate? Would it not be wise--indeed mandatory--for Congress to first know, with some degree of precision, the true magnitude of the problem that allegedly exists before enacting such drastic legislation?

Answer: The answer to your first question is that very few, if any, dealerships have closed during the past ten years as a result of unfair refiner competition. While a great many dealerships have closed during the past ten years, unfair competition does not appear to be the cause. The DOE study titled The State of Competition in Gasoline Marketing provides some insight into the number of closings. Chapter VI of that study indicates that there has been a decline in the number of retail outlets in all categories of distribution over the last ten years. The decline in the number of retail outlets has been concentrated in the refiner supplied category, that is, among directly operated outlets, lessee dealers, and open dealers. Table 6-4 (enclosed) taken from the study summarizes the decline in outlets from 1972 through 1980. Tables 6-1 and 6-6 indicate the decline in number of outlets generally and the change in the number of jobber supplied outlets.

The entire thrust of the DOE study was aimed at determining the cause of this decline in retail outlets. The ultimate conclusion was that the decline was not occurring because of any general anticompetitive activities on the part of refiner-operators in the marketplace. Many reasons are presented for this decline and shift in marketing, including the desire to increase profits in marketing, changing economic conditions, changing consumer preferences, and the anomalies of the price and allocation controls.

The answer to the second part of the question, simply stated, is yes. Legislation should be based upon informed views. The resources of the Department are available to provide any additional information to you in this regard.

> Question 4: Would the proposed elimination of competition from integrated refiner-operated stations be more likely to lead to higher or lower gasoline prices?

Answer: Elimination of competition from the marketplace will lead to higher gasoline prices than would otherwise prevail.

Question 5: What is the rationale for arbitrarily limiting application of divorcement to 16 refiners?

Answer: We do not know the rationale for specifying these companies. Certainly, there is no indication that this group of companies is moving to direct operations to a greater extent than any other group of refiners. Furthermore, as pointed out in the Title III report, almost half the increase in sales at company-operated outlets was accounted for by only four companies. (See Table 4-4 enclosed.) Historically, the subsidization allegation was that integrated refiners used crude oil profits to subsidize their gasoline marketing operations. While the Title III report makes clear that such conduct was highly unlikely ever to have happened and certainly does not happen today, this may be the underlying rationale for singling out these companies.

Question 6: Are the definitions of small and independent refiners in S. 326 consistent with those used by the IRS and the SBA?

Answer: The definitions of small and independent refiners differ. It could be, however, that different definitions are appropriate for different purposes. The Title III report discusses a number of alternate definitions of a "major" oil company at pp. 2-4, and for expositional convenience adopted the EPAA definitions of small and independent. It noted, however, that there were substantial differences among these firms. "For example, the list includes companies with massive marketing networks, such as Exxon and Texaco, and companies with relatively small marketing networks such as Citgo and Conoco." (p. 4)

Question 7: How many refiners would not be covered by the divorcement provisions of Section 2(a)(1) because they are "independent refiners" as defined in Section 2(e)(3)? Who are they? How many service stations do they own and operate themselves and how much gasoline do they market through these stations?

Answer: The total number of refiners not covered by the divorcement provision is not known with precision. There are about 190 refiners in the U. S. that could be included. Of these, however, 70 principal refiners, which are also marketers, report data to the DOE on Form P306. (Reporting has stopped in September 1981 while the form is under review by OMB.) There may be other refiner-marketers that do not report on the form, for example, SIGMOR, but they would be a small component of the total universe. Consequently, by excluding the 16 affected companies, one can conclude that 54 refiner-marketers are not covered by the divorcement requirement. (A list of the 54 refiner-marketers is attached.)

Note, however, that all 54 companies did not report in every year. In particular, several companies did not report by 1980 due to liquidation, merger, or withdrawal from either refining or marketing. Thus, the data provided here should be considered rough approximations.

According to the P306 data, companies not affected by the divorcement requirement distributed gasoline through 20,281 outlets in 1972 and 13,699 outlets in 1980. The number of outlets directly operated by these companies, however, remained fairly constant from 1972 to 1980--5,834 and 5,782, respectively. The total annual volume of gasoline sold through these company outlets was approximately 9.6 billion gallons in 1972 and 9.5 billion gallons in 1980.

Sincerely yours,

Leonard L. Coburn
Acting Director
Office of Competition

Enclosures

cc: Honorable Paul Laxalt
United States Senate

TABLE 4-4

THE PRIME MOVERS INTO COMPANY STORE OPERATIONS AMONG THE 40 LARGEST REFINER-MARKETERS

Companies with the Largest Absolute Changes in Company-Store Sales 1972-78

Prime-Movers Group	Refiners	Increase (billions of gallons)	Percent of Total Increase
PM-1	Marathon, Gulf, Clark, and Sohio	3.4	48.6
PM-2	Citgo, Mobil, Vickers, and Ashland	1.4	19.7
PM-3	Hess, Tenneco, Tosco, Crown, United Refining, Conoco, Arco, Tesoro, Sun, Union, Total, and Little America	2.0	28.3
All Prime-Movers		6.7[*]	96.6
Total (All 40 Refiners)		6.9	100.0

[*] Sum does not add to total due to rounding.

Source: Form EIA-151.

Table 6-1

Selected Information On Primary Locations

1963-1977

Category	1963	1967	1972	1977
Number of Primary Outlets				
In operation at end of year	211,473	216,059	226,459	176,465
Operated entire year	180,879	199,937	197,220	151,582
Not in business at end of year	NA	NA	38,590	27,316
Outlet with no paid employees	35,614	58,081	46,935	26,619
Multi-unit operations				
Number of multi-unit operators	4,341	3,598	3,773	3,463
Number of primary outlets operated	23,070	23,293	28,704	33,828
Average size chain	5.3	6.5	7.6	9.8

Source: Bureau of the Census

Note: Category "Not in business at end of year" is essentially a count of retail operators that failed during the year. Thus an outlet which changed hands three times during a year and was in operation at the end of the year would be counted twice in the "Not in business" category and once in the "In operation at end of year" category.

Table 6-4

All Refiners: Number of Directly Supplied Retail Outlets and Average Volume For Months of January and July, 1972-1980

January	Company Stores		Lessee Dealers		Open Dealers		Total	
Year	No.	Avg. Vol.	No.	Avg. Vol.	No.	Avg. Vol.	No.	Avg. Vol.
1972	13,736	42.9	111,531	25.2	92,615	8.5	217,882	19.3
1973	14,047	47.8	107,434	27.5	87,539	10.1	209,020	21.6
1974	13,008	58.5	95,974	29.0	82,723	10.3	191,705	23.0
1975	15,110	54.8	86,771	29.5	77,407	11.1	179,288	23.7
1976	16,043	63.9	80,904	29.8	73,436	11.7	170,383	25.2
1977	16,839	64.7	68,177	34.7	63,227	13.6	148,243	29.1
1978	16,069	69.3	59,883	37.7	58,453	14.4	134,405	31.4
1979	15,010	79.1	54,320	44.8	51,351	18.0	120,681	37.7
1980	13,737	76.3	51,141	41.7	47,663	18.5	112,541	36.1

July	Company Stores		Lessee Dealers		Open Dealers		Total	
Year	No.	Avg. Vol.	No.	Avg. Vol.	No.	Avg. Vol.	No.	Avg. Vol.
1972	13,546	51.6	110,158	29.1	91,314	10.9	215,018	22.8
1973	13,156	60.3	102,190	34.0	86,261	13.2	201,607	26.8
1974	13,575	58.8	91,518	35.0	80,433	14.2	185,526	27.7
1975	16,073	59.7	84,493	33.7	77,944	14.0	178,510	27.5
1976	17,292	66.4	74,777	37.1	67,729	15.8	159,798	31.2
1977	16,385	75.9	65,021	40.2	62,972	16.9	144,378	34.1
1978	15,696	83.1	57,860	45.0	57,819	17.9	131,375	37.6
1979	14,329	80.6	53,569	41.7	52,155	18.6	120,053	36.3
1980	13,583	84.2	49,556	45.9	47,646	19.4	110,785	39.2

Note: Average Volumes (Avg. Vol.) in thousands of gallons.
Note Also: Data for 50 States and District of Columbia.
Source: EIA Forms P-305/P-306.

Table 6-6

An Estimate of Number of the Primary, Secondary, and Jobber Supplied Retail Outlets

Year	Private Research Company Estimate of Retail Outlets Total	Primary	Secondary	Refiner Supplied Outlets	Estimate of Jobber Supplied Outlets
1973	332.9	215.9	117.0	201.6	131.3
1974	302.1	196.1	105.9	185.5	116.6
1975	288.7	189.5	99.2	178.5	110.2
1976	279.4	186.8	92.6	159.8	119.6
1977	264.4	177.4	87.0	144.4	120.0
1978	252.2	172.3	79.9	131.4	120.8
1979	240.2	164.8	75.5	120.1	120.1
1980	229.5	158.5	71.0	110.8	118.7

Note: Estimate for July each year in thousands of outlets. The source of the private estimate is confidential. Number of refiner-suppied outlets is from Form P-306. Preliminary research suggests that refiner data for the years 1973-1975 may be slightly overstated. The purpose of this table is to suggest the number of non-refiner supplied retail outlets.

Note also: Rows may not add due to rounding.

FIFTY-FOUR REFINER-MARKETERS NOT AFFECTED BY THE DIVORCEMENT PROVISIONS OF S. 326[*]

Agway Petroleum
Amerada Hess
American Petrofina
APCO Oil Company
Ashland
Beacon Oil
Canal Refining
Caribou Four Corners
Cenex Farmers Union
Champlin Petroleum
Charter Oil
Clark Oil and Refining
Commonwealth Oil
Crown Central
Crystal Oil
Diamond Shamrock
Earth Resources
Evangeline Refining
Farmland Industries
Good Hope Industries
Growmark Inc.
Hunt Oil
Husky Oil
ICG Vista Petroleum
Indiana Farm Bureau
Kerr-McGee
Koch Industries
Land O Lakes
Little America
M F A Oil Company
Murphy Oil
Navajo Refining
Pace Oil Company
Pennzoil
Powerine Oil
Quaker State
Reserve Oil and Gas
Rock Island Refining
South Hampton Refining
Southern Union Refining
Southland Oil Company
Sunland Refining
Tenneco Inc.
Tesoro Petroleum
Texas City Refining
The Coastal Corporation
Thriftway Company
Thunderbird Resources
Tosco
Total Petroleum
Union Texas Petroleum
United Refining Company
Vickers Petroleum
Witco Chemical Corporation

---

[*] These companies have reported data on DOE Form P306. Not all listed companies are currently in operation; others now operate under different names.

MEMORANDUM

Re: S. 326 -- Small Business Motor Fuel
Marketer Preservation Act of 1981.

This memorandum outlines questions regarding the constitutional validity of certain provisions of S. 326, as well as the relationship of the bill to existing law -- specifically the Sherman Act and the Robinson-Patman Act.

A. Background: Department of Energy Study.

Title III of the Petroleum Marketing Practices Act (Pub. L. 96-297) required the following:

> Sec. 301. (a) The Secretary of Energy, in consultation with the Chairman of the Federal Trade Commission and the Attorney General and other agencies as the Secretary deems appropriate, shall conduct a study of the extent to which producers, refiners, and other suppliers of motor fuel subsidize the sale of such motor fuel at retail or wholesale with profits obtained from other operations.
>
> (b) Such study shall examine --
> (1) the role of vertically integrated operations in facilitating subsidization of sales of motor fuel at wholesale or retail;
>
> (2) the extent to which such subsidization is predatory and presents a threat to competition;
>
> (3) the profitability of various segments of the petroleum industry;
>
> (4) the impact of prohibiting such subsidization on the competitive viability of various segments of the petroleum industry, on prices of motor fuel to consumers and on the health and structure of the petroleum industry as a whole; and
>
> (5) such other matters as the Secretary considers appropriate.

The Energy Department's final report was issued in January, 1981. The key findings of the study are:

1. There has not been a massive movement by refiners into the direct retailing of gasoline. Based upon a detailed analysis of nationwide and statewide trends, a handful of refiners, in limited marketing areas,

account for the present movement of refiners into the direct retailing of gasoline.

2. No evidence has been developed from a detailed analysis of five SMSA's, Atlanta, Boston, Fort Wayne, Houston, and Los Angeles, using a variety of analytic techniques, that refiners are subsidizing the sale of gasoline at retail as part of a predatory campaign. To the contrary, it appears that such sales are made for pecuniary reasons and not for predatory reasons. When viewed in light of the increase in sales of gasoline to independent marketers collectively, this evidence becomes more convincing.

3. Changing economic and marketing conditions are primarily responsible for the movement to high-volume, self-service stations and away from the low-volume, full-service network. Changing consumer preferences, increasing operating and construction costs, changing expectations of developments in crude oil markets, and competition from independent marketers were the driving forces behind these changes. Under the regulatory system developed in the 1970s, dealers as a group may have been unable to participate in the trend to higher volume outlets.

4. The price and allocation regulations of the Department of Energy are the most anticompetitive factors operative in today's gasoline market and are a driving force behind many of the trends found in this report. With the exception of these regulations, it appears that an assessment by the United Kingdom's Director of Fair Trading of similar charges regarding the role of vertically integrated petroleum companies in that nation could be applied to the United States.

   "Many of the complaints arise from the existence of competition rather than from its absence. It is noticeable that the complaints arise primarily from within the trade rather than from the motoring public." Quoted from Bureau of National Affairs, Inc., "Antitrust and Trade Regulation Report," No. 988, November 6, 1980, p. A-5.

5. The documents subpoenaed from nine integrated oil companies confirm and support the analytic findings indicated above.

"The State of Competition in Gasoline Marketing," DOE/PE-0026, January, 1981.

B. Issues Raised by S. 326.

1. Under the commerce clause, if activity is to be regulated or prohibited by Congress, the activity must have a real or substantial relation to the national interest and the means chosen by Congress must be reasonably adapted to achieve the desired affect on interstate commerce. Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 255, 262 (1964); see also, Lawton v. Steele, 152 U.S. 133 (1894).

Congress may not attempt to accomplish by legislation enacted pursuant to its commerce clause power that which can only be accomplished through a Fifth Amendment taking for which just compensation is required. See Pennsylvania Coal v. Mahon, 260 U.S. 393 (1922).

Thus, the following questions concerning the subject legislation are raised:

(a) Does the S. 326 sale of station on a right-of-first-refusal basis provision (Section 2(a) constitute a taking of private property without due process of law?

(b) S. 326 is designed in part to eliminate competition and help keep in business a specified class of firms. Is this objective an abuse of Congress' commerce clause powers because it benefits private parties rather than the general public?

2. The Fifth Amendment precludes the United States from taking private property for private purposes. See O'Neill v. Leanier, 239 U.S. 244 (1915); Swan Lake Hunting Club v. United States, 381 F.2d 238 (5th Cir. 1967). Under S. 326 a refiner could not sell or dedicate to any other use a retail station under lease to a dealer if that dealer wants to buy the property. Is this a congressionally-authorized taking of private property for public purposes or congressionally-authorized taking of private property for private purposes?

3. The Fifth Amendment prohibits Congress from taking private property without paying the owner just compensation; the measure of the just compensation is a judicial question. Monongahela Navigation Co. v. United States, 148 U.S. 312, 327 (1893). S. 326 requires that before any refiner disposes of any interest in a retail service station operated by a dealer, it must first offer to sell, on a right-of-first-refusal basis, to the occupying dealer. If the two parties cannot agree on price, the price at which the refiner must sell is to be set by an independent appraiser, not by a court.

(a) Does not this procedure violate the owner's Fifth Amendment right to have just compensation for the taking of private property judicially determined?

(b) If S. 326 is enacted, would not the United States, every time a dealer exercised the right of first refusal and the taking price is determined by an independent appraiser, face liability in the United States Court of Claims for the difference between the fair market value at the date of taking and the price set by the appraiser, plus interest thereon until paid?

4. In reviewing part I of the DOE's Title II study, the Justice Department concluded that while the data were not complete and were subject to a number of qualifications, predatory subsidization did not appear to be practiced in the markets studied. The Department stated, in general comment on divorcement and divestiture laws and price controls, that those laws and controls

> all protect one group of firms (e.g., franchised dealers), regardless of whether the group's rivals' conduct is anti-competitive. The result is the prohibition of competitive

> behavior induced by valid market incentives, a result which is detrimental to consumers.

Letter, January 20, 1980, Deputy Assistant Attorney General, Antitrust Division, to William W. Lewis, Assistant Secretary for Policy and Evaluation, Department of Energy.

In light of this conclusion and the findings of the Title III study that (i) there is no burden on interstate commerce resulting from the continuation of retail operations by integrated refiners; (ii) legislation such as S. 326 favors one class of businessmen; and (iii) the bill would have a detrimental effect on consumers, is S. 326 a valid exercise of congressional power under the Commerce Clause?

5. Do the alleged predatory practices sought to be eliminated by S. 326 already, to the extent existing now or in the future, constitute violations of Federal law (the Sherman Act and the Robinson-Patman Act) subject to civil and criminal sanctions?

STROM THURMOND, S.C., CHAIRMAN
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ROBERT DOLE, KANS.
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JOHN EAST, N.C.
CHARLES E. GRASSLEY, IOWA
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ARLEN SPECTER, PA.
JOSEPH R. BIDEN, Jr., DEL.
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HOWARD M. METZENBAUM, OHIO
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QUENTIN CROMMELIN, JR., STAFF DIRECTOR

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, D.C. 20510

October 26, 1981

Mr. Leonard L. Coburn
Acting Director, Office of
Competition
Office of Congressional Inter-
governmental & Public Affairs
Department of Energy
1000 Independence Ave., S.W.
Washington, D.C. 20585

Dear Mr. Coburn:

Attached are questions regarding S. 326 that Senator Laxalt would like you to answer. Please respond in writing within seven days so that your answer may be included in the printed record of the July 30th hearing.

With best wishes and kindest regards,

Sincerely,

Strom Thurmond
Strom Thurmond

SENATOR LAXALT

QUESTIONS FOR DEPARTMENTS OF JUSTICE AND ENERGY

1. Do you perceive that the divorcement and pricing provisions of S. 326 would have adverse impact on the distribution of motor fuel?

2. If the "open supply" provision of S. 326 were enacted, how can the supplier and retailer assure compliance with trademark protection laws, truth in advertising laws, and state and federal laws against misbranding and commingling of products?

3. Is there any way to quantify the percentage of number of dealerships which have closed during the past ten years as a result of alleged unfair refiner competition which S. 326 and H.R. 1362 seek to alleviate?

Would it not be wise -- indeed mandatory -- for

Congress to first know, with some degree of precision, the true magnitude of the problem that allegedly exists before enacting such drastic legislation?

4. Would the proposed elimination of competition from integrated refiner-operated stations be more likely to lead to higher or lower gasoline prices?

5. What is the rationale for arbitrarily limiting application of the divorcement to 16 refiners?

Comment: Such companies as Vickers, Ashland, Hess, Tenneco, Tosco, Crown, United Refining and Tesoro -- all labeled by DOE as "prime movers" into direct retail operations -- are exempt from coverage.

6. This bill exempts so-called "small" and "independent" refiners -- those whose refining capacity does not exceed 175,000 barrels per day, and those who supply no more than 30% of their own crude oil needs. These are the same arbitrary designations used in the now obsolete Energy Petroleum Allocation Act. How do these designations square with the longstanding IRS and SBA regulations which describe "small" and "independent" refiners as companies with only 50,000 barrel per day capabilities, without regard to the source of its crude oil?

7. How many refiners would not be covered by the divorcement provisions of Section 2(a)(1) because they are "independent refiners" as defined in Section 2(e)(3)? Who are they? How many service stations do they own and operate themselves and how much gasoline do they market through these stations?

United States Department of Justice

ASSISTANT ATTORNEY GENERAL
LEGISLATIVE AFFAIRS

WASHINGTON, D.C. 20530

NOV 16 1981

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This is in response to your letter of October 26, 1981, enclosing follow-up questions from Senator Laxalt concerning S. 326, the "Small Business Motor Fuel Marketer Preservation Act of 1981." I am pleased to respond to those questions.

1. Q. Do you perceive that the divorcement and pricing provisions of S. 326 would have adverse impact on the distribution of motor fuel?

A. The divorcement and pricing provisions of S. 326 would adversely impact the distribution of motor fuel by increasing the costs of distribution. To the extent that there are economies in vertical integration, these economies will be lost if the bill is enacted. In some cases, a refiner may have to create an independent network, not now existing, to distribute its gasoline. This will increase costs of distribution to integrated refiners and these costs will be passed on to consumers.

2. Q. If the "open supply" provisions of S. 326 were enacted, how can the supplier and retailer ensure compliance with trademark protection laws, truth in advertising laws, and state and federal laws against misbranding and commingling of products?

A. The open supply provisions of S. 326 will make it very difficult for refiners to ensure compliance with trademark laws, truth-in-advertising laws, and state and federal laws against misbranding and commingling of products. Since the supplier could no longer require the retailer to purchase all product from itself, the supplier would have to monitor all of the retailers' product purchases to detect and prevent commingling or misbranding.

3. Q. Is there any way to quantify the percentage or number of dealerships which have closed during the past ten years as a result of alleged unfair refiner competition which S. 326 and H.R. 1362 seek to alleviate?

A. There have been many widely varying estimates of the numbers of independent dealers who have gone out of business during the past ten years. Of course, there may be a variety of reasons why certain dealers will go out of business.

In 1978, Congress enacted Title III of the Petroleum Marketing Practices Act, 15 U.S.C. § 2841, which required the Department of Energy to study the extent to which suppliers unfairly compete with their dealers by subsidizing their company-owned operations. This provision was enacted so that Congress could determine the extent of the problem before enacting remedial legislation. This Report, published in January 1981, found no evidence of predatory subsidization or any other unfair competition by integrated refiners. Rather, as DOE found, the decrease in the number of independent dealers has been a result of changed consumer preferences and unduly burdensome DOE regulations. Thus, the evidence which does exist suggests there is no competitive problem. While the Department recognizes that many independent dealers have closed in the past ten years, we are not aware of evidence that any of those dealers were forced from business by anticompetitive means. Of course, we would be happy to review any specific information that may tend to establish the existence of anticompetitive practices.

The Department agrees that before enacting legislation such as S. 326, Congress should have credible evidence that there is a competitive problem. In the absence of such evidence, this legislation should not be enacted.

4. Q. Would the proposed elimination of competition from integrated refiner-operated stations be more likely to lead to higher or lower gasoline prices?

A. The elimination of one class of competitors, as well as the loss of any efficiencies gained through integration, will tend to increase gasoline prices to consumers.

5. Q. What is the rationale for arbitrarily limiting application of the divorcement to 16 refiners?

A. The Department does not have any knowledge as to why the divorcement provisions of this bill are limited to the 16 "major" refiners. To the extent that there has been a decrease in the number of independent dealers of the so-called "non-major" refiners, the bill's limitation to the so-called "major" refiners does not logically follow.

6. Q. This bill exempts so-called "small" and "independent" refiners -- those whose refining capacity does not exceed 175,000 barrels per day, and those who supply no more than 30% of their own crude oil needs. These are the same arbitrary designations used in the now obsolete Energy Petroleum Allocation Act. How do these designations square with the longstanding IRS and SBA regulations which describe "small" and "independent" refiners as companies with only 50,000 barrel per day capabilities, without regard to the source of its crude oil?

A. The definitions of "independent" refiners for purposes of these various statutory schemes are different and will inevitably create confusion.

7. Q. How many refiners would not be covered by the divorcement provisions of section 2(a)(1) because they are "independent refiners" as defined in section 2(c)(3)? Who are they? How many service stations do they own and operate themselves and how much gasoline do they market through these stations?

A. The Department does not have sufficient information to respond to this question. However, this information should be obtainable from the Department of Energy.

I trust this information is responsive to Senator Laxalt and will assist the Committee in its consideration of this legislation. As you know, the Department of Justice strongly opposes enactment of this bill.

Sincerely,

Robert A. McConnell

Robert A. McConnell
Assistant Attorney General

STROM THURMOND, S.C., CHAIRMAN
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United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, D.C. 20510

October 26, 1981

Honorable William French Smith
The Attorney General
U.S. Department of Justice
Washington, D.C. 20530

Dear Mr. Attorney General:

Attached are questions regarding S. 326, the "Small Business Motor Fuel Marketer Preservation Act of 1981" that Senators Laxalt, Hatch, Simpson and East would like you to answer. Please respond in writing as expeditiously as possible so that the mark-up on this legislation will not be unduly delayed.

With best wishes and kindest regards,

Sincerely,

Strom Thurmond
Strom Thurmond

Senators Laxalt, Hatch, Simpson and East

The Judiciary Committee has legislation under consideration that would require the divorcement of motor fuel service stations from operation by certain refiners (S. 326). We have a number of questions about this proposed legislation that were not addressed or not fully answered at the hearings held on this bill. Primarily, our questions concern constitutional issues which should be examined before the Committee schedules a mark-up of the bill.

Therefore, we would appreciate receiving your Department's responses to the matters outlined in the enclosed memorandum. A copy of S. 326 is also enclosed.

United States Department of Justice

ASSISTANT ATTORNEY GENERAL
LEGISLATIVE AFFAIRS

WASHINGTON, D.C. 20530

NOV 16 1981

Honorable Strom Thurmond
Chairman, Committee on the Judiciary
U.S. Senate
Washington, D. C. 20510

Dear Mr. Chairman:

This responds to your request of October 26, 1981, for the views of the Department of Justice on the questions propounded by Senators Laxalt, Hatch, Simpson, and East in a memorandum relating to S. 326, "The Small Business Motor Fuel Marketer Preservation Act of 1981" (hereinafter referred to as "Senate Memorandum.")

The bill would prohibit major refiners from operating retail gasoline stations. The bill would also require establishment of a daily wholesale transfer price for motor fuel and, with certain limited exceptions, would require a supplier of motor fuel to sell or transfer fuel only at that price, including sales to independent wholesale purchasers or to any person "related" to the supplier. The bill would further prohibit any person from restraining or interfering with dealers wishing to purchase, store, or sell motor fuel purchased from another supplier. In testimony before your committee on October 21, 1981, Assistant Attorney General Baxter of the Antitrust Division strongly opposed enactment of the legislation on the grounds that the bill would severely disrupt the petroleum industry without any evidence that the competitive market had failed to serve the consumer efficiently and that the likely severe anticompetitive effects of the bill would exacerbate any market failure that had been demonstrated.

The Senate Memorandum now submitted for our views raises a number of constitutional issues implicating the Commerce Clause and the Fifth Amendment Due Process Clause. In addition, the Senate Memorandum raises a question of statutory interpretation under the Sherman Act and the Robinson-Patman Act. We address these issues in turn.

I. Constitutional Issues

We would like to begin with a general discussion of the relevant constitutional principles and then focus more particularly on the specific questions that the Senate Memorandum raises.

A. Commerce Clause

It is true, as the Senate Memorandum suggests at p. 3, that "[u]nder the Commerce Clause, if activity is to be regulated or prohibited by Congress, the activity must have a real or substantial relation to the national interest and the means chosen by Congress must be reasonably adapted to achieve the desired effect [sic] on interstate commerce. Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 255, 262 (1964)." But it is just as true that legislation does not lose its character as related to the national interest merely because it benefits a specific segment of the population. Much social and economic legislation, including the 1964 Civil Rights Act itself, is designed to benefit or protect certain private parties. See, e.g., Fullilove v. Klutznick, 448 U.S. 448 (1980) (minority business enterprise provision of Public Works Employment Act of 1977); United States v. Darby, 312 U.S. 100 (1941)(Fair Labor Standards Act); NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937)(National Labor Relations Act). What is important is that Congress acts upon findings that the effect on the individual of the conduct to be prohibited is "national in scope," Fullilove, supra, 448 U.S. at 478, and that it "has an effect on interstate commerce." Id. at 475. See also North American Co. v. SEC, 327 U.S. 686, 706 (1946): "Once it is established that the evil concerns or affects commerce in more states than one, Congress may act."

In this respect, of course, Congress is not limited to the factual findings and conclusions in the Department of Energy final report. Congress may hold its own hearings, conduct its own studies, and draw its own reasonable conclusions. We assume, and, more importantly, courts reviewing legislation such as S. 326 could be expected to assume, that Congress, when it acts, will have before it "evidence of the burdens that [the prohibited practices] plac[e] upon interstate commerce." Compare Heart of Atlanta Motel, supra, 379 U.S. at 252. Moreover, "Congress, of course, may legislate without compiling the kind of 'record' appropriate with respect to judicial or administrative proceedings." Fullilove, supra, 448 U.S. at 478.

On this discussion, we think it clear that, upon the basis of appropriate data that vertical integration, differential pricing, and other aspects of S. 326 adversely affect commerce, the legislation, if enacted, would not be invalid under the Commerce Clause. Neither the "desig[n] in part to eliminate competition and help keep in business a specified class of firms," Senate Memorandum at 4, nor the asserted conclusion and findings of the Department of Energy study, Senate Memorandum at 6, would be controlling. 1/

B. Due Process Clause

Again, we begin with the relevant general principles. It is beyond question, as the Senate Memorandum points out at p. 4, that "[t]he Fifth Amendment precludes the United States from taking private property for private purposes," that

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1/ There is also a recitation in the first question raised by the Senate Memorandum that "Congress may not attempt to accomplish by legislation enacted pursuant to its Commerce Clause power that which can only be accomplished through a Fifth Amendment taking for which just compensation is required. See Pennsylvania Coal v. Mahon, 260 U.S. 393 (1922)." The validity of the objective of the legislation may be the same under the Commerce Clause and the Fifth Amendment. The differencen is the validity of the means, that is, whether payment of compensation is required. This question, therefore, does not seem to be any different from the specific questions raised in the Senate Memorandum on the takings issue; and so we address this aspect in the next section of our letter.

"[t]he Fifth Amendment prohibits Congress from taking private property without paying the owner just compensation," and that "the measure of just compensation is a judicial question." In the context of S. 326, there are several distinct features to be considered: the requirement of divorcement, the obligation to offer the dealer the right of first refusal, and the use of an independent appraiser to set the price if the parties cannot agree.

That the requirement of divorcement itself raises no takings problem was settled in *North American Co. v. SEC*, 327 U.S. 686 (1946). In that case, the Supreme Court upheld the divestment provision of the Public Utility Holding Company Act of 1935 against various constitutional challenges, including one based on the Due Process Clause. Given the balancing by Congress of the benefits to the company of integration and the actual and potential damage to the public from that structure, the Court held that it could not be said that there had been "a vast destruction of values." *Id.* at 708. And neither "[t]he fact that valuable interests may be affected," *id.*, nor that "the status quo [would not] be maintained," *id.* n. 15, raised any due process question.

We would also point out that a divestiture requirement similar to that contained in S. 326 was imposed in Maryland by state statute and subsequently challenged in state court by a number of oil companies on various constitutional and federal statutory grounds. Again, a takings claim was raised. The Maryland Court of Appeals rejected all allegations of unconstitutionality and preemption. The takings claim was not pursued in the Supreme Court, which did, however, uphold the validity of the statute. *See Exxon Corp. v. Maryland*, 437 U.S. 117 (1978). The Court also pointed out that four other States at that time restricted refiners' operation of service stations and that similar proposals have been before the legislatures of thirty-two other jurisdictions. *Id.* at 128 n. 18.

It seems similarly clear to us that if the requirement of divorcement does not constitute a taking, there is also no taking implicated by the requirement that the refiner offer the dealer the right of first refusal on the purchase of the station. Again, on the basis of appropriate findings, if the refiner can be obligated to sell, he can be further obligated to sell to a particular person. Congress, it seems to us, could reasonably determine, and the courts could reasonably agree, not only that divestment is in the public interest, but that sale to the dealer is also in the public interest. Incidental benefit to private persons does not convert the purpose of governmental action from public to private in the context of procedural or substantive due process, any more than under the Commerce Clause. *See O'Neill v. Leamer*, 239 U.S. 244, 251-54 (1915); *Swan Lake Hunting Club v. United States*, 381 F.2d 238, 241-42 (5th Cir. 1967).

The constitutional issue raised by the right of first refusal concerns not the identity of the purchaser, but the amount of compensation received. We turn, then, to an examination of this third aspect of S. 326.

The Court in *North American, supra*, in upholding the divestment provisions, relied on the Act's requirement of "standards of fairness and equitableness" and the scrutiny by the SEC and the enforcing courts of any divestment plan. 327 U.S. at 709-10. The comparable pricing provisions of S. 326 provide that if the refiner and the dealer cannot agree on a price, the price shall be determined by "an independent appraiser" selected in conformity with standards prescribed by the Small Business Administration.

We have no reason to believe that the price set by the independent appraiser would not reasonably reflect fair market value and thus satisfy the constitutional requirement of just compensation. It would be open to the refiner, of course, to argue to a court that it did not. This option would provide the refiner with its judicial determination of the measure of just compensation. See Monogahela Navigation Co. v. United States, 148 U.S. 312, 327 (1893). There is no facial unconstitutionality to the appraisal process itself, and we would not lightly assume that the statute would be unconstitutionally applied. 2/

The above discussion should suffice to answer the questions raised in the Senate Memorandum about whether the right-of-first-refusal option constitutes a taking, either for private or public purposes, and whether the use of an independent appraiser is contrary to the judicial function under the Fifth Amendment of determining the amount of just compensation for a taking.

II. Statutory Issues

The Senate Memorandum also inquired as to whether the alleged predatory practices sought to be eliminated by S. 326 already constitute violations of federal law (the Sherman Act and the Robinson-Patman Act). S. 326 is a response to a variety of complaints made by independent service station dealers about the conduct of their suppliers. Some of these complaints, if factually accurate, would raise issues cognizable under the antitrust laws, while others would not. One such complaint is that integrated suppliers are driving their independent dealers out of business. Where there is evidence of predatory intent or anticompetitive effect, efforts by suppliers to eliminate independent dealers could violate the Sherman Act. However, the Department has found no convincing evidence that such conduct is occurring. Rather, independent dealers appear to be failing for reasons unrelated to anticompetitive actions by their suppliers.

While the antitrust laws would not prohibit all the types of conduct complained of, they would prohibit conduct which is harmful to competition. The antitrust laws do not prohibit an integrated supplier from terminating its dealers where that conduct is neither predatory nor anticompetitive. Where a supplier terminates a dealer for a sound business justification, as where that dealer is no longer profitable to it, the antitrust laws would not be violated because there has been no injury to competition. Thus,

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2/ We note the specific question in the Senate Memorandum at p.5 whether "the United States, every time a dealer exercised the right of first refusal and the taking price is determined by an independent appraiser, [would] face liability in the United States Court of Claims for the difference between the fair market value at the date of taking and the price set by the appraiser, plus interest thereon until paid." The issue of liability by the United States would not arise "every time a dealer exercised the right of first refusal." It would arise, if at all, only upon a further determination by the court that the amount determined by the appraiser did not in fact provide the refiner with "just compensation." If the refiner secured a judicial determination that that the appraised price constituted less than just compensation, we assume that the United States would be liable for the difference.

the antitrust laws provide a better approach to this situation than the one proposed by S. 326. While the bill broadly prohibits relationships and conduct which may be procompetitive, the antitrust laws are carefully tailored to prohibit only such relationship or conduct which is competitively harmful.

I hope that these responses will be helpful to the Committee.

Sincerely,

Robert A. McConnell

Robert A. McConnell
Assistant Attorney General
Office of Legislative Affairs

John S White
Special Counsel
Government Affairs

Marathon Oil Company

1800 M Street NW
Washington DC 20036
Telephone 202/331 1340

October 30, 1981

The Honorable Strom Thurmond, Chairman
Committee on the Judiciary
United States Senate
2226 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

At the October 21, 1981, hearing on S. 326, Ms. Tiffany asked Mr. G. N. Nicholson, Vice President, Marketing, of Marathon Oil Company "....whether the retail price at the unbranded Marathon station might ever be below the wholesale price Marathon is charging to its distributors...." (T. 198).

The question and the comparison it seeks to draw, as applied to Marathon, is susceptible to several interpretations. This is because Marathon wholesales different gasolines to different classes of customers (most of whom are broadly "distributors") under different conditions and at different prices. The matter of price differentials is of evident concern to members of the Committee, and we believe Ms. Tiffany was seeking to determine whether the retail price at an outlet operated by Marathon's marketing subsidiary might ever be less than the Dealer Tank Wagon (DTW) price Marathon charged its branded dealers and, if so, whether there are any reasons other than predatory pricing to explain such differentials. The answers to both these questions are "yes," but further explanation is required for full understanding.

Marathon itself does not operate any retail gasoline outlets. A Marathon subsidiary operates about 735 retail outlets under a number of secondary brands (not the Marathon brand). Marathon does not establish the prices at these subsidiary operated units. The subsidiary has and exercises complete retail pricing autonomy. Marathon wholesales different gasoline in various ways. As of today, our established wholesale reseller price for regular gasoline in Columbus, Ohio (a typical terminal) is $1.013 per gallon. This is the price paid by private brand resellers, including our subsidiary. It covers only the commodity and contemplates delivery at Marathon's terminal, i.e., it does not include transportation of the product to the reseller's stations. Assuming average transportation costs of $.015 per gallon these customers would, therefore, have a "laid-in" cost of regular gasoline at the service station of about $1.028 per gallon. Naturally freight costs will vary by distance hauled.

Today, throughout Ohio, Marathon's dealer tankwagon price -- the price paid by our branded dealers -- for branded regular gasoline is $1.0755. This price includes transportation to the station.

The dealer thus pays $.0475 per gallon more than the "laid-in" cost of a private brand reseller. However, this comparison is misleading for the following reasons: (1) the gasolines sold to Marathon branded dealers are of a different and higher quality than those sold to private brand resellers; and (2) Marathon branded dealers receive added value from a number of brand services, including use of the Marathon credit card, benefit of substantial advertising promoting the Marathon brand and sales assistance and training, not available to private brand resellers. These inclusive services and benefits provided by Marathon to its branded dealers are additional costs to us and are, therefore, reflected in the price we charge dealers. Accordingly, comparing Marathon's dealer tankwagon price for a higher quality product and addes services to the price charged private brand resellers is really comparing two different things. Our dealer tankwagon price and our wholesale reseller price are, quite simply, fundamentally different.

Marathon's unbranded wholesale reseller customers, including its subsidiary, compete in the "no-frill" segment of the market. If other competitors in that segment retail their products at a price lower than our "rack" price plus four and three-quarter cents, then Marathon's unbranded gasoline customers (including its marketing subsidiary) would have to respond to meet that competition or risk losing business. Under such conditions, one or more of such customers could be selling at retail below our dealer tankwagon price.

Such a condition would not, in our opinion, be the normal state of the market because all retailers attempt to maximize profits. Neither is it indicative of predatory pricing by refiners. Rather it is a carry over of the traditional "rack" versus "DTW" pricing structure which was frozen into the gasoline delivery system at the beginning of federal price controls in the early 1970s. These controls essentially prevented adaptation to changing market conditions. Since the scrapping of such controls on January 28, 1981, these traditional pricing systems and relationships have been in the process of re-examination and change. It is to be expected, as we recede further from controls, that market forces will produce further changes and adjustments in relationships and in pricing policies -- changes in both kind and degree. Any legislative intervention now would subvert this normal, healthy and beneficial market process.

We believe that branded, full service dealers and private brand gasoline-only outlets cater to different segments of the market and compete, if at all, only at the margins of those segments. Thus, the fact that a private brand reseller temporarily establishes a retail price below Marathon's dealer tankwagon price is not likely to produce any significant lasting competitive effects in another market segment.

In summary, there are three important points your committee should bear in mind:

(1) Marathon's wholesale reseller customers, including its marketing subsidiary, do not compete with our branded dealers in the same market segment. Branded dealers obtain from Marathon a substantially better product and more services (credit cards, delivery at service station, advertising, etc.) than do private brand resellers. In turn, they generally offer full service and compete for the consumer who wants extra conveniences -- and is willing to pay a little more. Their competitors are other full-service facilities, not gasoline-only outlets.

(2) Our subsidiary strives to be profitable. It operates its outlets so as to recover all its costs plus a profit and generally it does so. It is not a price leader, but meets its competition's street price.

(3) Operations of our marketing subsidiary and our full-service dealers are not comparable. The only common denominator is that each group offers gasoline. From there on, everything is different -- delivery points, customers, methods of operation, costs, philosophies, station architecture, trademarks and very importantly the quality of gasoline.

I hope this response offers some insight into a question that is persistent. If you have additional questions, I would be pleased to entertain them.

Very truly yours,

John S. White

John S. White

JSW:dm

CROWN CENTRAL PETROLEUM CORPORATION

CROWN

PRODUCERS · REFINERS · MARKETERS OF PETROLEUM PRODUCTS AND PETROCHEMICALS

GENERAL OFFICES · ONE NORTH CHARLES · P.O. BOX 1168 · BALTIMORE MARYLAND 21203

November 12, 1981

JESSE D. WINZENRIED
GROUP VICE PRESIDENT

The Honorable Strom Thurmond
Chairman, Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Senator Thurmond:

In response to your letter of October 26, 1981, I am pleased to provide the following information:

1. Price Spreads of Wholesale Gasoline Among Different Refiners.

Senator Grassley asked me to provide information on differences in refinery wholesale prices, which he had previously been informed had a maximum deviation over a long period of time of seven-tenths of a cent per gallon.

We have computed the range of dealer tank wagon (DTW) prices in twenty-six cities in Petroleum Administration for Defense District I for September 10, 1981 as reported in the September 14, 1981 U.S. Oil Week. Only in one city, Fairfax/Newington, Virginia, was the spread between the high and low refiner DTW prices for a given grade less than a penny. The average price spread was 2.56 cents for leaded gasoline, and 2.67 cents for unleaded, with maximum differences of 4.80 cents. These observed differences affirm my statements at the Hearing, that on any given day there is a far greater range than seven-tenths of a cent in the DTW prices charged by different refining companies.

2. The Effect of Divorcement on Crown Central's Profitability in Maryland.

Although it is impossible to calculate the effect of divorcement on Crown's overall profitability in Maryland, it is possible to generate some statistics which demonstrate the effect which it has had on our operations at the stations involved.

During the first half of 1979, Crown's company-operated stations in Maryland netted back to Crown approximately 1.23 cents per gallon more than similar dealer operations within the state, even though the posted prices at company-operated stations averaged only slightly more than 1 cent below the average Maryland dealer. If you were to multiply this 1.23 cents per gallon by every gallon purchased by the post-divorcement dealers at the stations involved, the effect would be a revenue loss in excess of $700,000.

November 12, 1981

The Honorable Strom Thurmond
United States Senate

This does not take into effect the decline in volume which has been experienced at the divested stations since conversion to dealer operation.

In the period January-June 1979, prior to divorcement July 1, 1979, Crown's eleven divested stations had an average volume of 241,400 gallons per month (GPM). Since then, volume at those stations has been declining steadily. For the year 1980, post-divorcement average volume at the eleven stations fell 12% to 212,800 GPM. The downward spiral has accelerated this year. For the first nine months of 1981, volume at the eleven stations is averaging 21% less than in the first six months of 1979. Most recently in September, 1981, gallonage sold through these eleven stations is averaging only 139,600 GPM, 34% below the 1980 average and 42% below January-June, 1979, prior to divorcement.

In contrast, total Maryland gasoline consumption in the first eight months of 1981, based on State tax reports, was down only 3.5 percent from the first eight months of 1979.

The reduction in volume cannot be attributed to high refiner wholesale prices charged to our dealers because the U.S. Oil Week price tabulation provided in response to the Question 1 above shows that Crown's wholesale pries were the lowest of the Baltimore refiner's DTW prices reported.

The answer is that the retail margins charged by our dealers have increased, by about four cents per gallon as reported in Attachment V of my prepared October 21, 1981 statement. Thus, the result of divorcement is increased prices paid by consumers. The dealers increased their prices compared to the levels that were charged when the stations were company-operated. And our volume and profitability of those stations declined.

Respectfully submitted,

Jesse D. Winzenried
Group Vice-President

JDW/EPM/agh

**REFINER DEALER TANKWAGON PRICE RANGES
FOR UNLEADED AND LEADED
REGULAR GASOLINE
(HIGH MINUS LOW)

(14)

6pt

U.S. **oil week**

INCLUDES REFINER PRICE MOVES THROUGH SEPT. 10, 1981

Biweekly Supplement to U.S. Oil Week, Sept. 14, 1981

Prices for PADs 3, 4 and 5 will appear next week

Price supplement contacts
Our price supplement is prepared by Anne Stein and Pat Lancaster. If you've got any suggestions, complaints, price changes, etc., give Pat or Anne a call at 703-528-1100. Call collect.

Prices at key terminals in PAD 1

														**PRICE RANGE
Albany, NY	Amoco	Ashland	Cibro	Chevron	Citgo	Exxon	Getty	Gulf	Mobil	Pittsta	Sousa	Sunoco	Tenneco	
No. 2 reseller	104.50	103.00	100.50	102.25	103.02	103.80	103.00	102.50	104.00	104.00	97.50	102.85	101.75	
Lead reg. reseller	106.15d	105.00	105.55	— —	105.98	— —	— —	106.30	107.20	— —	103.50	— —	103.50	
Lead reg. DTW	— —	— —	— —	109.50	— —	108.00	109.90	110.30	111.10	— —	— —	110.80	— —	3.10cents
Unl. reg. reseller	110.15d	109.00	109.00	— —	109.98	— —	— —	110.30	111.20	— —	108.50	— —	107.50	
Unl. reg. DTW	— —	— —	— —	113.50	— —	112.00	114.90	114.30	115.10	— —	— —	115.80	— —	3.80cents
Atlanta, GA	Amoco	Ashland	Chevron	Citgo	Crown	Exxon	Fina	Gulf	Maratho	Mobil	Shell	Tenneco	Union	
No. 2 reseller	100.65	99.00	99.85	100.27	97.50	100.50	98.80	100.20	97.00	104.00	— —	99.00	102.10	
Lead reg. reseller	102.70d	102.50	— —	104.00	102.50	— —	103.30	103.10d	101.50	— —	102.40	102.00	104.00	
Lead reg. DTW	— —	— —	107.20	— —	103.55	107.20	— —	— —	— —	106.80	— —	— —	— —	3.65cents
Unl. reg. reseller	106.70d	106.50	— —	108.00	106.50	— —	106.30	106.10d	105.50	— —	107.40	106.00	108.00	
Unl. reg. DTW	— —	— —	111.20	— —	107.55	111.20	— —	— —	— —	110.80	— —	— —	— —	3.65cents
Baltimore, MD	Amoco	Ashland	B P	Chevron	Citgo	Conoco	Crown	Exxon	Gulf	Mobil	Shell	Sunoco	Tenneco	
No. 2 reseller	102.50	104.00	97.50	101.95	102.54	101.00	97.50	102.40	102.00	103.00	— —	99.75	101.00	
Lead reg. reseller	— —	103.25	102.50	— —	103.41	103.00u	103.50	104.30	104.00	— —	103.80	104.60	102.15	
Lead reg. DTW	107.60	— —	— —	107.90	— —	— —	105.15	108.00	108.00	108.20	— —	— —	105.65	3.05cents
Unl. reg. reseller	— —	107.25	106.50	— —	109.41	107.00u	107.50	108.60	108.00	— —	107.80	108.60	106.15	
Unl. reg. DTW	111.60	— —	— —	111.90	— —	— —	109.65	112.00	112.00	112.20	— —	— —	109.65	2.55cents
Boston, MA.	Amoco	B P	Belcher	Chevron	Citgo	Exxon	Gulf	Mobil	N. East	Pittst	Quincy	Sousa	Warren	
No. 2 reseller	103.00	— —	100.80	102.75	102.40	103.90	106.75	103.90	103.90	103.40	103.40	101.00	100.00	
Lead reg. reseller	— —	105.50	105.50	— —	105.65	— —	— —	— —	105.50	— —	[illegible]	104.50	103.50	
Lead reg. DTW	109.60	— —	— —	108.50	— —	109.20	110.30	109.40	— —	— —	— —	— —	— —	1.70cents
Unl. reg. reseller	— —	109.50	110.00	— —	108.65	— —	— —	— —	110.20	— —	110.80	109.50	107.50	
Unl. reg. DTW	113.60	— —	— —	112.50	— —	113.20	114.20	113.40	— —	— —	— —	— —	— —	1.70cents
Buffalo, NY	Amoco	ARCO	Ashland	Citgo	Exxon	Gulf	Mobil	Newman	Sunoco	Texaco				
No. 2 reseller	104.60	101.60	101.00	— —	104.00	102.80c	103.00	99.50	103.25	— —				
Lead reg. reseller	106.70d	105.45	104.00	104.62	103.80	106.30	107.70	103.70	107.00	108.35				
Lead reg. DTW	110.00	— —	— —	— —	108.60	110.30	110.80	— —	109.80	— —				2.40cents
Unl. reg. reseller	110.70d	108.45	108.00	108.62	108.45	110.30	111.70	107.70	111.00	112.35				
Unl. reg. DTW	114.00	— —	— —	— —	112.60	114.30	114.80	— —	113.80	— —				2.40cents
Charleston, SC	Amoco	Citgo	Exxon	Fina	Gulf	Hess	Maratho	Phillip	Shell	Tenneco	Texaco	Union		
No. 2 reseller	101.00c	102.00	103.50	99.20	99.75	100.25	98.00	102.00d	— —	102.00	102.60	102.30		
Lead reg. reseller	103.70d	105.57	105.45	102.45	103.50	— —	102.20	104.15d	103.80d	102.00	105.75	105.05d		
Lead reg. DTW	— —	— —	109.00	— —	— —	— —	— —	— —	— —	105.50	— —	— —		3.50cents
Unl. reg. reseller	107.70d	109.57	109.45	106.45	107.50	— —	106.20	108.15d	107.80d	106.00	109.55	109.05d		
Unl. reg. DTW	— —	— —	113.00	— —	— —	— —	— —	— —	— —	109.50	— —	— —		3.50cents
Charlotte, NC	Amoco	Citgo	Coastal	Crown	Exxon	Fina	Gulf	Mobil	Murphy	Phillip	Shell	Texaco	Union	
No. 2 reseller	99.80	101.23	97.10	97.50	101.60	99.20	100.95	102.00	98.00	— —	— —	105.00	102.60	
Lead reg. reseller	102.65d	104.51	102.60	102.50	102.75	102.45	102.75	— —	102.75	103.15d	102.55	106.00	104.65	
Lead reg. DTW	106.40	— —	— —	— —	107.50	— —	— —	107.70	— —	— —	106.80	— —	— —	1.30cents
Unl. reg. reseller	106.65d	108.51	106.60	106.50	106.75	106.45	106.75	— —	106.75	107.15d	106.55	109.80	108.65	
Unl. reg. DTW	110.40	— —	— —	— —	111.50	— —	— —	111.70	— —	— —	110.80	— —	— —	1.30cents
Fairfax/Newington	Amoco	ARCO	B P	Citgo	Exxon	Gulf	Mobil	Phillip	Shell	Tenneco	Texaco	Union		
No. 2 reseller	102.00	97.20	— —	102.42	— —	102.00	104.35	102.30	— —	101.00	104.85	102.95		
Lead reg. reseller	105.40d	105.25d	102.55	104.20	— —	104.00	104.60	104.80	102.42	102.40	106.20	106.05d		
Lead reg. DTW	— —	— —	— —	— —	108.70	108.80	108.70	— —	— —	— —	— —	— —		0.10cent
Unl. reg. reseller	109.40d	108.25d	106.55	108.20	— —	108.00	108.40	108.80	106.42	106.40	110.20	110.05d		
Unl. reg. DTW	— —	— —	— —	— —	112.70	112.80	112.70	— —	— —	— —	— —	— —		0.10cent
Greensboro, NC	Amoco	Ashland	Citgo	Exxon	Fina	Gulf	Maratho	Mobil	Shell	Sunoco	Tenneco	Union		
No. 2 reseller	100.50	99.00	101.23	101.50	99.20	— —	97.30	102.50	— —	102.60	101.00	102.10		
Lead reg. reseller	102.50	102.50	104.58	103.80	102.45	103.30	101.80	— —	— —	105.10	102.00	104.25		
Lead reg. DTW	106.30	— —	— —	107.60	— —	— —	— —	107.70	106.80	— —	105.50	— —		2.20cents
Unl. reg. reseller	106.25	106.50	108.58	107.80	106.45	107.30	105.80	— —	— —	109.10	106.00	108.25		
Unl. reg. DTW	112.30	— —	— —	111.60	— —	— —	— —	111.70	110.80	— —	109.50	— —		2.80cents
Jacksonville, FL	Chevron	Citgo	Colon.	Exxon	Fina	Gulf	Maratho	Mobil	Phillip	Tenneco	Texaco	Triangl	Union	
No. 2 reseller	97.55	102.48	97.50	103.50	99.30	101.50	98.90	103.20	100.15d	99.00	100.30	101.00c	103.20	
Lead reg. reseller	103.45	105.62	102.25	104.75d	103.28	105.40	103.20	— —	102.00	102.00	106.75d	104.00	104.85	
Lead reg. DTW	— —	— —	— —	107.70	— —	108.90	— —	109.00	— —	105.50	— —	— —	106.05	3.50cents
Unl. reg. reseller	107.25	109.62	106.25	108.75d	107.28	109.40	107.20	— —	106.00	106.00	110.55d	108.00	108.85	
Unl. reg. DTW	— —	— —	— —	111.10	— —	112.90	— —	113.00	— —	109.50	— —	— —	110.05	3.50cents
Macon, GA	Amoco	Chevron	Citgo	Crown	Exxon	Fina	Gulf	Maratho	Mobil	Murphy	Phillip	Tenneco	Union	
No. 2 reseller	102.65	98.30	100.37c	97.75	— —	98.80	100.70c	97.00	104.00	99.00	100.20	99.00	102.10	
Lead reg. reseller	103.70d	— —	104.00	102.50	— —	102.30	101.80	101.50	— —	103.25	103.00d	102.00	104.65d	
Lead reg. DTW	— —	107.60	— —	103.55	107.70	— —	105.80	— —	106.80	— —	— —	105.50	— —	4.25cents
Unl. reg. reseller	107.70d	— —	108.00	106.50	— —	106.30	105.80	105.50	— —	107.25	107.00d	106.00	108.65d	
Unl. reg. DTW	— —	111.80	— —	107.55	111.70	— —	109.80	— —	110.80	— —	— —	109.50	— —	4.25cents
Miami, FL	Amoco	Ashland	Charter	Chevron	Citgo	Exxon	Fina	Gulf	Maratho	Mobil	Shell	Sunoco	Union	
No. 2 reseller	— —	— —	98.50	103.00*	101.88c	— —	99.30	101.05c	98.40	103.20	— —	— —	103.00	
Lead reg. reseller	— —	103.50	102.70	— —	105.35	— —	103.28	105.55	102.70	— —	106.00d	— —	106.00d	
Lead reg. DTW	108.40	— —	— —	108.00	— —	107.70	— —	108.85	— —	108.00	— —	109.30	— —	1.60cents
Unl. reg. reseller	— —	107.50	106.70	— —	109.35	— —	107.28	109.55	106.70	— —	110.00d	— —	110.00d	
Unl. reg. DTW	112.40	— —	— —	112.00	— —	111.70	— —	112.85	— —	112.00	— —	113.30	— —	1.60cents

PRICES SHOWN ARE REFINERY PRICES FOB TERMINAL IN ¢/GAL. EXCLUDING TAXES, DISCOUNTS, HAULING ALLOWANCES AND FREIGHT CHARGES.

(MORE PAD 1 TERMINALS ON NEXT PAGE)

Chevron

Chevron U.S.A. Inc.
575 Market Street, San Francisco, CA 94105
Mail Address: P.O. Box 7643, San Francisco, CA 94120

D. L. Mulit
Vice-President
Marketing

October 15, 1981

The Honorable Strom Thurmond
Chairman, Judiciary Committee
U.S. Senate
2226 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Thurmond:

Enclosed is the statement of Chevron U.S.A. in response to the "Small Business Motor Fuel Marketer Preservation Act of 1981," S.326. Chevron wishes to make this statement part of the official record of the Committee as it deliberates on the merits of the proposed legislation.

Very truly yours,

D. L. Mulit

cc: Members of the
Judiciary Committee

100 Years Helping to Create the Future

EXECUTIVE SUMMARY

S. 326 is a far-reaching bill dealing with fundamental marketing issues. These include provisions divorcing 16 major refiners from their company-operated stations, establishment of uniform pricing, measures allowing open supply and provisions granting lessee dealers "rights of first refusal" on refiner sale of service stations under an extremely rigid formula.

Chevron believes this bill would be detrimental to consumers, would impede natural evolutionary processes in the marketplace as it adjusts to decontrol and ironically, would hurt the interests of conventional, branded dealers.

Divorcement. Dealers contend that their refiner suppliers have used predatory pricing tactics to drive them from their stations and that refiners are taking over gasoline marketing with company stations. These arguments do not withstand objective analysis. The structure of the retail gasoline market is so diverse that no refiner could expect to drive everyone else from the market. Furthermore, every marketer knows that barriers to entry are low enough that new service stations most certainly would enter the market and provide more competition.

A Department of Justice report concluded that "genuine predation, i.e., pricing below short run marginal costs, is rare." The Department of Energy's report on the "State of Competition in Gasoline Marketing," known as Title III, concluded: "No evidence has been developed from a detailed analysis of five SMSA's...that refiners are subsidizing the sale of gasoline at retail as part of a predatory campaign."

In support of the claim that refiners are taking over marketing, dealers say that 100,000 dealers have gone out of business and that 2,800 refiner stations have opened. It strains credulity to suggest that these company-operated stations could take over the business of 100,000 dealers.

The claimed takeover of retail gasoline marketing by major refineries is a myth. The greatest sales growth has been realized by private brand outlets, such as convenience stores and mass merchandisers, jobbers and independent refiners, not the major oil companies that are targeted for divorcement. In response to consumer demand, there has been a shift away from conventional stations to gas and go type operations. To put the matter in perspective, gasoline sales by the 28 largest refiners through their company-operated stations amounted to only 11% of the market in 1978-79.

Divorcement legislation would hit consumers in the pocketbook. DOE in its Title III Report concluded, "In 1978 EIA estimates that the average differential between the selling price at major refiners' Company stores and major brand independent marketers was 2.8 cents. This implies that divorcement would have resulted in a monthly income transfer of approximately $18 million or an annual transfer from consumers to dealers of $216 million in 1978." (These calculations are based on the period prior to the Iranian upheaval and the doubling of oil prices by OPEC.)

Uniform Pricing. S. 326 could force any marketer who performs a true jobber function to go out of business. One of the principal complaints of dealers is the increase in the number of jobbber salary operated stations. What the proponents of the bill fail to realize is that the jobbers, faced with mandatory uniform pricing, would, as a matter of survival, be encouraged to integrate forward into retail marketing. Would this help dealers?

Brand Surcharge, Open Supply. Chevron is concerned that the breadth of the open supply provision and the failure of the bill to consider the practical problems involved, along with the brand surcharge provision, will lead to the demise of brand marketing. If a dealer follows the practice of putting different gasolines into his service station tanks at different times, there will be many problems. Adulteration, contamination of unleaded products and improper commingling of differing octanes will occur unless tanks are properly purged. Consumer deception and the long-condemned practice of "passing off" will become common unless it is made very clear to the consumer that unbranded or commingled products sold at the station are not supplied by the brand-name refiner. There is an element of consumer deception in any event if a motorist drives into a station and finds that brand-name gasolines are not available or that they are available only in limited amounts or in certain grades.

If brand marketing ends, the conventional dealer will be seriously hurt because he relies on the assurance of high quality products and services which the brand gives. The effect of the bill would be to help the large private brand operator who currently faces substantial competition from the branded lessee dealer offering a full range of products and services.

Service Station Sales to Individual Dealers. The "right of first refusal" provided in the bill is no more than a thinly disguised attempt to require refiners who wish to sell their stations to do so on a fire sale basis. There is nothing fair about either the concept or the procedure. First, the refiner makes an offer. Then the dealer makes a counteroffer. If the refiner does not like the counteroffer submitted by the dealer, he apparently is mandated to sell the property at an appraised price to the dealer leasing the premises. A fair procedure already exists under the Petroleum Marketing Practices Act and this would be repealed. In many communities, land prices have risen substantially. S. 326 would not only prevent the owner of the station site from selling the property at its real market value but would prevent the land from being employed for its highest and best use.

Recommendations. Chevron strongly recommends against further legislative intervention in the marketplace at this time. A DOE regulatory approach has clearly failed to help dealers. Suppliers and dealers are just beginning to adjust to a decontrolled market. Laws passed before this adjustment process is completed would be premature and would undoubtedly create new problems.

DOE also cautions against new legislation. The Title III study recommends "Decontrol, coupled with vigorous enforcement of existing antitrust laws, is a preferred alternative to further administrative 'tinkering' with the market".

Chevron believes that every type of business operation -- small or large -- has its own unique contribution to make. No one segment of the economy should receive favored treatment. As the Department of Justice has stated:

> "* * * A policy of extending undue competitive advantages to small businesses -- or stated somewhat differently, of imposing competitive disadvantages on larger businesses -- would be contrary to the public interest and ultimately would be a disservice to small business itself. Such a policy would undermine a cherished right of small business: the right to grow and prosper to the fullest extent of its capabilities and potential, unhindered by anticompetitive forces. We believe that the success of any business, large or small, should be determined by its ability to produce the quality of goods and services its customers want, at the lowest possible prices."

The consumer and the Nation as a whole prosper only if laws are enacted which help to nourish true competition throughout the economy.

Introduction

Chevron U.S.A., an integrated refiner, is most appreciative of the opportunity to present its views on S. 326. This bill, which is usually referred to as a divorcement bill, deals with a whole series of fundamental marketing issues affecting gasoline marketing in additon to the divorcement issue.

We believe this bill would be detrimental to consumers, would prevent normal evolutionary market changes necessary to a healthy gasoline economy and ironically would hurt the conventional branded dealers even though the evident purpose of the bill's proponents is to protect this class of trade.

A. Economic and Regulatory Background

The past eight years have been a period of transition in the United States petroleum marketing industry. Before the oil embargo petroleum marketing was oriented primarily toward full service stations offering lubrication, engine tune-ups and a full line of automotive products. Thereafter rising costs for crude oil brought significant changes to gasoline marketing. As a result of the shortage and resulting high cost of gasoline, consumers increasingly sought the lowest priced products available.

Marketing strategies changed rapidly to meet changing consumer demand. The popularity of self-service pumpers, both branded and unbranded, offering lower prices increased significantly. Foodstores, department stores, and mass merchandisers installed gasoline pumps. Car washes sometimes offering a free wash with a fillup were built. Automotive Service Centers were constructed emphasizing a high degree of skill and efficiency and competitive prices.

The proponents of S. 326 suggest that the problems experienced by branded dealers have been caused by their suppliers. In fact, suppliers had to contend with the same forces that have affected dealers. Suppliers who were not willing to adjust to new market realities suffered the same damages and reverses as their dealers.

Some full service stations that were only marginally profitable before 1974 closed because of high operating costs, lowered demand for gasoline and poor efficiency. Those full service dealers who have adjusted to the demands of the marketplace and have maintained efficient operations have increased their volumes and their profits. Independent marketers and small refiners have built company operated self service units which, because of their efficiency, have become increasingly popular with price conscious motorists. Some major refiners operating their own units have adopted the same marketing style used by the independents and have passed on the cost savings to their customers.

During the period of the 1970's DOE regulations caused problems for all marketers and particularly for branded dealers. Because of the regulations dealers had difficulty increasing their allocation of motor fuel, while jobbers could easily receive increased allocations for new stations. Aided by the regulatory process, jobbers (and some dealers supplied by them) made substantial gains in volume, while many other dealers found their volume slipping. DOE pricing regulations, for a time, required refiners' company-operated stations to sell gasoline at prices anywhere from 8¢ to 20¢ below the prices charged by competing dealers. It is easy to see why dealers might regard these prices as "predatory", but the fault was with federal regulations, not suppliers who were mandated to charge lower prices.

In 1978, in response to dealers' cries that their suppliers were "driving them out of business", Congress directed the DOE to study competition in gasoline marketing. Title III of the 1978 Petroleum Marketing Practices Act asked DOE to report on the extent to which producers, refiners and other suppliers of motor fuel "subsidize" the sale of motor fuel at retail, with profits from other operations.

DOE presented its report (probably the most comprehensive study ever conducted on gasoline marketing) to Congress in January, 1981. After a lengthy analysis of petroleum marketing strategies of major refiners during the 1970's, DOE found no industry trend by refiners toward company-operated stations. Instead, different refiners have pursued different strategies. They further reported no "predatory" campaign by refiners to subsidize their company stores. DOE concluded that "Decontrol, coupled with vigorous enforcement of existing antitrust laws, is a preferred alternative to further administrative 'tinkering' with the market". (Title III Report, Page ES 10.)

Chevron believes that in light of DOE's conclusion that decontrol will best ensure a healthy and competitive marketplace, Congress should examine the need for new legislation and carefully weigh the benefits of S.

326 against its potential for harm to consumers and to the competitive process.

B. Provisions Concerning Divorcement

S. 326 would make it unlawful "* * * for any refiner, other than an independent refiner or a small refiner, to operate any motor fuel service station in the United States". Proponents of "divorcement" legislation claim this bill is needed because predatory pricing by integrated refiners through their company-operated stations is driving dealers out of business and because independent service station dealers are dwindling in numbers due to the claimed proliferation of refinery company-operated stations.

1. Predatory Pricing

"Predatory pricing" usually means selling below cost with the intent to injure competition. According to Professors Areeda and Turner, "predation in any meaningful sense cannot exist unless there is a temporary sacrifice of net revenues in the expectation of greater future gains". (Areeda and Turner, Antitrust Law (1978) Vol. III, pp 151-152). They describe the successful case of predatory pricing as one in which prices are temporarily dropped to drive rivals out of the market, then increased once the competition dwindles. If rivals in a market have equal resources or "staying power" or if new competitors can easily enter the market, predatory pricing is impossible to achieve. After a review of the case law and recent empirical studies, the Department of Justice concluded in 1977 that "genuine predation, i.e., pricing below short-run marginal costs, is rare" (U. S. Department of Justice, Report on the Robinson-Patman Act (1977), p. 164).

Clearly, the structure of the present retail gasoline market is so diverse that predation as described above is not possible. There are refiners whose primary business is supplying dealers, refiners who rely mostly on company stations, chain retailers with many individual outlets and many jobbers who sell either to dealers or direct to the consumer through salary-operated stations. With this structure, the various dealers competing in a market, who are usually backed by the resources of a supplier, could not be forced out by predatory prices charged at a refiner's company-operated stations. Other refiners and jobbers would follow with counterstrategies to protect the service stations they supply.

Even if one believes that a predatory campaign could somehow eliminate rival service station dealers from a market, one must ask whether the barriers to entry are high enough to prevent other competitors from entering. The service station business is characterized by the existence of many rival sellers. Although construction costs for new stations have increased, the marketing of petroleum products has always been and remains a business characterized by relative ease of entry. If profits were thought to be high in a given market, new entries would most certainly occur. One reason why this is true is that private brand marketers represent a very important factor in most markets. Over the years, these marketers have competed successfully with the major brands on the basis of price. Indeed, they were in a better position than other marketers to provide products on a lower price, no frills basis in the aftermath of the oil embargo. It should come as no surprise that these marketers have made substantial gains in market share during the past few years. Significantly, this has occurred during the very time when major integrated oil companies are supposed to have been engaged in a predatory campaign to drive dealers out of the market.

DOE confirms independent marketers have significantly increased their market power since 1972. Authors of the Title III study examined the internal planning documents of major oil companies specifically for information they contained concerning the reasons for these companies' decisions to expand or divest operations at various functional levels in various geographic markets. They found the investment strategies of these companies had been designed to keep up with competition from these independent marketers.

> "Beginning in 1970-72, a series of internal reports concluded that the major integrated companies were no longer competitve at the retail level with the independent marketers. . ."(Title III, Book 2 page 17.)

Finally, the authors of the Title III Report found no evidence of any predatory subsidization. In addition to major oil companies internal planning documents, five major markets were studied in depth. The authors reported:

> "The contention that the growth in refiners'company-store activity and the decline in the directly supplied dealer network constitutes evidence of predatory subsidization must be tempered by the realization that the increase in other independent marketers' sales volume is more than twice the increase experienced at refiners' company stores. (Title III Report, page ES 5.)

2. The Takeover Myth

Dealer representatives claim that the company-operated stations of integrated refiners are taking over marketing. To support this dire prediction, dealer representatives assert that during the period from May 1972 to May 1979 "more than 100,000 dealers were being eliminated" while the number of refiner company stations increased by approximately 2800 outlets.

Even if these statistics were correct -- and they are not --the inference of a "takeover" by refiner company-operated stations is plainly wrong. This Spring the Department of Energy's Title III Report furnished facts on refiners' marketing trends or strategies. DOE found that there has been no uniform movement by major refiners to replace dealers with company operated units. While some refiners have expanded their network of company stations, others have reduced the number directly operated. Still others have maintained a relatively constant number of direct operated outlets. This is what one would expect in a competitive market.

An analysis of Table 4-2 of the Title III Report, which covers the forty largest refiner-marketers in the U.S. suggests that the greatest shifts in volume share to company stores applies to the smaller refiners, not to the larger companies which would be impacted by S. 326.

Before the Title III Report was released DOE published its preliminary conclusions in a paper called "Trends in Company Stores". This study contains a table showing the increase in company operated retail outlets between 1972 and 1979. The data show that the 18 largest refiners including those targeted for divorcement by S. 326 added 248 direct operated stations to their retail marketing networks. Smaller refiners, those with a production capacity of 10,000 to 215,000 barrels per day, increased the number of direct operated retail outlets by 1,680. Based on the above data DOE concluded in the Title III Report "the growth in refiners' salaried operations is principally accounted for by non-major refiners". (Title III Report, p. ES-5). (Most recent data on total refiner penetration into direct retail operation shows that from 1972 to 1980 the increase in number of all refiner stations totaled a mere 92).[1]

S. 326 does not take into account the other active developments which have occurred in petroleum marketing: the growth of private brand outlets such as convenience stores and stations operated by mass merchandisers (usually department stores) and the dramatic spurt in the number of stations supplied and/or operated by jobbers. The "Lundberg Letter" of March 27, 1981, reported that:

1/ Department of Energy (Federal Energy Administration) Report 5, Universe Estimates of Branded Motor Gasoline Sales.

> "Jobbers have become the principal gasoline marketers in the United States. Their share of the U.S. gasoline market rose to 51.3% by November 1980. Considering jobbers had approximately 35% of the market as recently as 1972, this is a landmark achievement." (Lundberg Letter, March 27, 1981, page 1).

As noted earlier, economic change has been the primary reason for upheaval in the service station business. Under a product shortage environment, fewer stations were constructed. With higher operating costs, the growth of large station pumpers, operated by private branders, mass merchandisers and jobber-operated outlets was a natural response to the consumer's demand for lower priced gasoline on a no frills basis. The full-service station was hardest hit by these developments. The impact of economic change was felt not only by the conventional branded lessee and open dealer but also by the conventional company-operated station of major refiners.

The March 20, 1981, "Lundberg Letter" reported on the changing economics of petroleum marketing. The report began by estimating that in the past 2 years 20% of the nation's gasoline stations have closed. Lundberg found that generally the stations that have survived have more pumps and higher volume capacity. Both volume capacity and the ability to perform mechanical services seem to be important variables affecting a station's viability in today's market, Lundberg concluded.

3. Impact on Competition and Consumers

The trend for the largest refiners is to make less use of company-operated stations. Therefore, this bill's impact would fall most heavily on the few smaller majors who place greater emphasis on this marketing method. It eliminates entirely the vigorous price competition of company stations operated by these refiners. Lessened competition would soon translate itself into higher prices for consumers. These results are totally at odds with the underlying objectives of the antitrust laws.

The broad implications of divorcement legislation have been considered by the Antitrust Division of the Department of Justice. Richard J. Favretto, Acting Assistant Attorney General of this Division, concluded that this type of legislation would have "severe anticompetitive repercussions." In his view, divorcement would substantially restructure the retail petroleum industry and would lead to higher consumer prices.

> "Prohibiting major oil companies from utilizing what they believe is the most efficient method of distributing motor fuel will not result in lower retail prices; rather, it is far more likely to force consumers to pay for a less efficient distribution method in the forms of higher gasoline prices or lesser availability of supply, or both." (Testimony of Richard J. Favretto before the Subcommittee on Energy, Environment and Safety Issues Affecting Small Business of the Committee on Small Business, House of Representatives, Washington, D.C., March 31, 1981, p. 13.)

Indeed we believe federal divorcement legislation could cause consumers to pay millions of dollars a year more for gasoline. The Department of Energy's Title III Report concluded:

> "Another legislative proposal receiving considerable attention is 'targeted' divorcement. This proposal bans all company-store operations by the 16 largest refiners. This proposal suffers from the same drawbacks as industrywide divorcement. However, this more modest proposal will still have a significant impact on the consumer's gasoline bill." (Title III Report, p. 236.)

According to the Report "targeted" divorcement could bring about three alternative results in terms of where consumers would purchase gasoline. The Report concludes that unless consumers purchased more gasoline from dealers the whole idea of divorcement would be a "hoax":

> "There are at least three scenarios: former customers of major refiners' company stores will purchase gasoline at other refiner-operated outlets, private-brand marketers' outlets, or dealer-operated outlets. In the first two instances, the market position of dealers will not change significantly. In this sense, divorcement is a hoax." (emphasis added) (Title III Report, p. 236.)

If it is assumed that "targeted" divorcement would cause consumers to purchase more gasoline from dealers, the Report concludes that consumers might have to pay hundreds of millions more every year:

> "In the third case, dealers may be better off, but customers will be worse off in terms of incurring a larger gasoline bill. Assuming that consumers do not quantity adjust, (i.e., reduce their consumption due to the higher price) the income transfer from consumers to dealers as a result of divorcement can be roughly estimated. For each one cent differential between the dealers' pump price and the refiners' company-store price, the monthly income transfer to dealers would have been $6,426,370 in 1978. In 1978, EIA estimates that the average differential between the selling price at major refiners' company stores and major brand independent marketer outlets was 2.8 cents. This implies that divorcement would have resulted in a monthly income transfer of approximately $18 million, or an annual transfer of $216 million from gasoline consumers to dealers in 1978. These calculations are detailed in Table 8-1." (Title III Report, p.236.)

In concluding this part of the discussion the DOE Report points out that, irrespective of the assumption made, "targeted" divorcement does not make good sense. "Thus, targeted divorcement would either increase consumers' gasoline bills or not significantly improve the market position of branded dealers." (Title III Report, p. 236.)

C. Requirements of Uniform Pricing.

The bill provides that every supplier whether jobber or refiner must sell gasoline at a uniform price, at every point of transfer, to independent wholesale purchasers. The term "independent wholesale purchaser" is defined to include both jobbers and retail dealers. This means that both jobbers and dealers would be charged the same base price.

Chevron objects to this uniform pricing system because it gives no recognition to the fact that jobbers' wholesale function in marketing is a necessary one. Historically gasoline has been sold to jobbers at a discount because their services augment a refiner's own distribution network. In secondary markets and rural areas jobbers supply essential services. They provide transportation and storage facilities for large quantities of motor fuel. They bring in new end user and reseller customers. They also extend credit and handle billing and customer complaints. In areas distant from major supply points jobbers alone supply dealers, farmers and other small businessmen. As a result of this discount, jobbers have been able to sell, store and transport fuel to their customers at prices reasonably comparable to those major oil companies charge for the products they deliver to dealers and, most importantly, to continue making a profit.

S. 326 would prohibit this price discount and permit jobbers to recover only the costs of their service. Any profit margin wholesalers recover would have to be added to the price they charge customers. Dealers supplied by jobbers would immediately be put at a significant cost disadvantage compared to dealers who buy from refiners. Customers in rural communities, commercial and industrial accounts who are dependent on jobbers as their source of supply would have to pay higher prices for their gasoline as a result of this bill.*

The logical consequence of uniform pricing would be for jobbers to integrate forward into retail marketing as quickly as possible. They would develop and expand chain marketing businesses. Jobbers transportation and storage equipment, business capital and experience would make them keen competitors in the retail market. It seems doubtful whether the average dealer would welcome this development.

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*(The price at which a refiner sells product to dealers is customarily called the dealer tank wagon price.)

We oppose uniform pricing provisions because we believe that ultimately they will undermine competition and prove to be be anti-consumer. Congress will be required to write new laws to correct the rigidities and inequities this system would create. In the end only the absence of such laws will enable the competitive process to work and guarantee consumer satisfaction.

It is not surprising that the Department of Justice, Antitrust Division, has become increasingly concerned about the conflict between government regulations and the objective of promoting competition, which underlies antitrust policy. The conclusion reached by former Assistant Attorney General John Shenefield is that we need less regulation, not more:

> "It is my belief that a closer examination of the realities * * * and some clear thinking will prove without doubt that the 'regulatory reflex' is precisely the wrong response.
>
> * * * * *
>
> "The lesson is clear. We should be extremely reluctant to attempt to duplicate what the marketplace clearly is best at doing: distributing goods and services equitably throughout our economy at fair prices. Of necessity, government intervention in the marketplace is a blunt instrument." ("An Antitrust Perspective on Energy Regulation: Giving Competition A Chance", by John H. Shenefield, Federal Bar News, Dec. 1979, pp. 203, 205).

D. Provisions Concerning Open Supply

The bill provides that "it shall be unlawful for any person to restrain, interfere with or in any way prevent the purchase from another, the storing or the selling of motor fuel by any dealer".

In our view, this provision would lead ultimately to the end of major brand marketing in the United States.

Implicit in the provision is the idea that the dealer should be free to buy gasoline from any source and to choose whether he sells on a branded or unbranded basis. Chevron does not question the right of its branded dealers to purchase competing gasolines and other products resold at service stations. An agreement between refiner and dealer requiring the latter to forego competitive products would violate S 3 of the Clayton Act (preventing exclusive dealing agreements) and S 1 of the Sherman Act (which provides against unreasonable restraints of trade).

We are concerned, however, that the breadth of the open supply provision and the failure of the bill to consider the practical problems involved will lead to the demise of brand marketing. If a dealer follows the practice of putting different products in his service station tanks at different times contamination can occur. Consumer deception and the long-condemned practice of "passing off" will occur unless it is made very clear to the consumer that unbranded or commingled products sold at the station are not supplied by the brand-name refiner. There is an element of consumer deception in any event if a motorist drives into a station and finds that brand-name products are not available or that they are available only in limited amounts or in certain grades.

No matter what precautions were taken, it is almost a certainty that the customer would hold the brand-name supplier responsible for any dissatisfaction with the products or services received at the station.

The net effect, as we see it, is that the bill's provisions will have the ultimate effect of discouraging suppliers from engaging in brand marketing. The hassles and economic costs will probably not justify the return, to say nothing of the deterioration of the value of the brand as a symbol of quality.

If brand marketing ends, the conventional dealer will be seriously hurt because he relies on the assurance of high quality products and services which the brand gives. The effectiveness of the Chevron brand is increased immeasurably when all service stations we supply in a given market area carry the brand. There is a synergistic effect. If individual service stations had the option to buy unbranded and a large number of them exercised that option, this would undermine the brand and the trademark identification of our products. The effect of the bill would be to help the large private brand operator who currently faces substantial competition from the branded lessee dealer offering a full range of products and services.

As a matter of interest, more than half of all retail outlets selling Chevron gasoline today are operated by independent businessmen who own their own stations or have leased them from a party not associated with Chevron. These dealers had freely chosen to sell Chevron brand products because they believe the brand will enhance the value of their businesses. (Also, they are free, on 30-day notice, to terminate their relationships with Chevron and choose another supplier)

Ironically, many dealers may suffer business failure because of a law Congress thought would help service station dealers compete. Proponents of open supply legislation seem to have little understanding of the dynamics of major brand marketing and the problems dealers will face if such laws are enacted.

E. Service Station Sale to Individual Dealers

The bill requires that if a refiner decides to sell its interest in a service station the dealer leasing the station must be offered a "right of first refusal". First, the refiner must give the dealer an exclusive 60-day option to accept the refiner's offer. During the 60-day period, the dealer may make a counteroffer. Within 30 days after the date of the counteroffer, the refiner must either agree to the dealer's counteroffer or submit a revised offer to sell the refiner's interest in the station to the dealer "at a price to be determined by an independent appraisal meeting the standards prescribed by the Small Business Administration".

Although the bill provides for what is euphemistically termed a "right of first refusal", there are no provisions at all for offers from third parties. If the refiner does not like the counteroffer submitted by the dealer, he apparently is mandated to sell the property at an appraised price to the dealer leasing the premises.

A fair procedure already exists under the Petroleum Marketing Practices Act (PMPA), which was enacted only after a thorough consideration of the underlying policy issues and full participation in the legislative process by all segments of the petroleum industry. Under PMPA, if a refiner "in good faith and in the normal course of business" decides to sell a service station which is leased to a dealer, the refiner must make "a bona fide offer" to sell his interest in the property to the dealer (§ 102 (b) (3) (D)). If the refiner has received an offer from a third party, the refiner must give the dealer, at no expense to him, a 45-day right of first refusal. In cases where the refiner decides to alter the premises, or to replace them, he is expressly prohibited from "converting the leased marketing premises to operation by employees or agents of the (refiner) for such (refiner's) own account" (§ 102 (b) (3) (D)). In other words, the refiner, under existing law, cannot turn the leased premises into a company-operated station.

In a free economy the local service station must compete for available sites with other business operations such as banks, fast food outlets and office buildings. In many communities, land prices have risen substantially. The proposed bill would not only prevent the owner of the station site from selling the property at its real market value but would prevent the land from being employed for its highest and best use. Thus, this bill can only be regarded as "protectionist" legislation designed to promote the narrow interests of a special group.

F. Dealer Complaints on Rents

The debate on nearly every legislative proposal dealing with petroleum marketing concerns certain complaints raised by dealers' trade organizations. Among them is the issue of dealer rents.

These organizations have accused refiners of using rent increases as a means of "economic eviction" of their dealers. There is no question but that the average rent paid by a service station dealer today is much greater than it was ten years ago.

Like all real property, service station values have increased significantly and rents have increased accordingly. While service station rents have taken sizeable jumps in the last several years, it must be remembered that these increases were made against a background of Federal rent controls which, during the period 1971 to late 1975, held service station rents to unreasonably low levels.

Government intervention meant dealers received service station rents which were lower than business rents generally during the period of controls, but faced a difficult readjustment problem when it became clear, in November, 1975, that service station rents could no longer be considered frozen.

Today the rents which Chevron is able to charge fall short of providing a reasonable rate of return on Chevron's service station investments. The location used for a service station site must compete with other business uses for the available land. Chevron is itself a land tenant with respect to approximately half of the service stations that it, in turn, leases to dealers. During the past few years, there have been many cases where rents paid by dealers to Chevron have not enabled Chevron to recoup the rents paid by Chevron to third-party landowners.

When it comes to assessing "blame", we believe Congress must take a hard look at the impact Government regulations have had on gasoline marketing. Chevron has done what it can -- within the framework of Government regulations -- to keep its dealers healthy. And since we are dependent to a large extent on dealers, it is in our own self-interest to continue to do so.

Conclusion

For the last decade, the petroleum industry has been subjected to relentless regulation. Despite the good intentions of Congress and DOE, these regulations have created innumerable distortions and needless inequities.

With the advent of decontrol, these distortions and inequities have been eliminated. The removal of this burden, plus the fact that no logical evidence exists to warrant a radical restructuring of motor fuel marketing in the United States, is the basis of Chevron's opposition to the passage of S. 326. After almost a decade of controls, the country needs to allow the free market to work in an unencumbered fashion.

Protectionism for a certain class of service station dealers is neither needed nor a desirable objective. Chevron believes that every type of business operation -- small or large -- has its own unique contribution to make. No one segment of the economy should receive favored treatment. As the Department of Justice has stated:

> "* * * A policy of extending undue competitive advantages to small businesses -- or stated somewhat differently, of imposing competitive disadvantages on larger businesses -- would be contrary to the public interest and ultimately would be a disservice to small business itself. Such a policy would undermine a cherished right of small business: the right to grow and prosper to the fullest extent of its capabilities and potential, unhindered by anticompetitive forces. We believe that the success of any business, large or small, should be determined by its ability to produce the quality of goods and services its customers want, at the lowest possible prices." Remarks of John H. Shenefield "The Future of Small Business in America". July 20, 1978, pp. 1-2.)

The consumer and the Nation as a whole prosper only if laws are enacted which help nourish true competition throughout the economy.

Chevron

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D. L. Mulit
Vice-President
Marketing

October 5, 1981

The Honorable Strom Thurmond
Chairman, Judiciary Committee
United States Senate
2226 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Thurmond:

On July 30, 1981 hearings were held by your Committee on S-326, the "Small Business Motor Fuel Marketer Preservation Act of 1981".

Chevron intends to submit a position paper on this legislation in conjunction with the next hearing which, we understand, is planned for October 21, 1981, with several major refiners scheduled to testify.

As a major marketer of petroleum products in the United States, with a large branded dealer network in place, Chevron has a vital interest in the ultimate disposition of S-326.

The enclosed paper was developed after a review of the transcript covering the July 30 hearing. There were a number of statements made and positions expressed which we believe are misleading and contrary to the actual events that have been taking place in the universe of gasoline marketing.

Chevron's response has been developed to enable committee members to view these events in a broader, more balanced context. I trust this will assist them in deliberating on the true merits of this legislation.

Sincerely,

Attachment

CHEVRON'S RESPONSE TO STATEMENTS MADE BY S.326 PROPONENTS AT SENATE JUDICIARY COMMITTEE JULY 30, 1981 HEARING

During the July 30th hearing on S.326 proponents made a number of statements that in our opinion are without foundation. These statements are evidently intended to make one believe S.326 will benefit both dealers and consumers.

Chevron believes S.326 is not in the public interest. Therefore, we have prepared a response to a number of these statements in hopes that Committee members will consider both viewpoints as they weigh the merits of this legislation. These statements appeared in the July 30th transcript of the Senate Judiciary Committee hearing on S.326 and address a number of the issues raised by the divorcement bill.

The Contract Relationship between Refiners and Dealers

Representative Berkley Bedell (D. IA.): " The central theme of S.326 and H.R. 1362 is the fact that we cannot count on the give and take of the normal contract bargaining process to assure equity in the relationships between motor fuel marketers and their suppliers." p. 5, line 16.

Proponents of divorcement believe not only that dealers need protection from suppliers who have an advantage in the bargaining process, but also that major refiners are using this advantage in a concerted effort to drive their dealers out of business. This judgement is based on unsubstantiated evidence. Indeed a thoughtful inquiry into the contract relationship would show the senselessness of such a policy.

The success of major refiner marketers is tied to the success of their dealers. Most of the sixteen companies impacted by divorcement legislation rely almost exclusively on branded dealer operations. They have made a huge financial commitment to this marketing style. If refiner marketers impose crippling costs and operating restrictions on their dealers, those dealers will go out of business. Refiners will suffer through investment loss and fewer outlets to merchandise their products. It is quite clearly in the Company's interests to keep its dealers economically healthy.

We recognize that in the past ten years many service stations have gone out of business. The shrinking service station population is the result of the changing economics of gasoline marketing. Inflation, changes in consumer preference, changes in traffic and population patterns, government regulation and reduced demand (for products and services) have all played a role in removing many low volume service station dealers from the marketplace.

There is no evidence to support the charge by proponents of S.326 that the dealer station population attrition has been caused by major refiners changing their gasoline marketing style from dealer-operated stations to direct company-operated units. Data published by the Department of Energy show that between 1972 and 1980, all refiner marketers, on average, increased the number of units they operate directly by a total of only 92.[1/] Clearly this tiny station increase is not responsible for the demise of dealer stations.

In any case, dealers' equity is already ensured by a number of federal laws designed specifically to protect the small businessman. Any attempt to drive service station

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[1/] Department of Energy (Federal Energy Administration) Report 5, Universe Estimates of Branded Motor Gasoline Sales.

dealers from a market could be challenged as attempted monopolization under section 2 of the Sherman Act (15 U.S.C. 2). Territorial price discrimination by a supplier's company stations located in adjoining localities is subject to the provisions of the Robinson-Patman Act (15 U.S.C. 13(a)). And, under section 5 of the FTC Act, the Commission has broad authority to prevent "unfair methods of competition in or affecting commerce" (15 U.S.C. 45). Where time is of the essence, preliminary injunctive relief before trial can be obtained to prevent conduct thought to be illegal.

The Open Supply Question

Prof. John Flynn, University of Utah: "The problem that is left, if divestiture takes place, is that most branded dealers will still be locked into a single supplier as a result of their franchise and trademark license, while their competitors are free to buy products at the best price they can." p. 35, line 6.

Professor Flynn's statement implies that most branded dealers are anxious to break their supply agreements. Chevron believes this is not the case. A look at the franchise relationship between suppliers and their dealers will explain why open supply is not in the dealer's interest.

A person who wants to become a gasoline dealer has two options. The first is to lease a station property from a supplier. This option has certain advantages. The initial investment is relatively low since the supplier builds the station and assumes the capital risk. The supplier remains responsible for the capital improvements on the property. The risk for the lessee dealer is moderate but the profit can be substantial. This option is only available because refiner marketers believe that a network of branded service station sites is valuable as an outlet for the products they refine.

The second option available to an independent businessman is that of purchasing or constructing his own station, or leasing the station from someone other than his supplier. Unlike the lessee dealer, this businessman may shoulder the entire capital investment, maintenance and financial risk, but he is free to choose his supplier, to sell branded or unbranded products and otherwise to operate his station as he chooses.

If Professor Flynn's thesis is correct, few dealer-owners would choose to do business with major suppliers. However, more than half of all retail outlets selling Chevron gasoline today operate under this arrangement. These dealers have freely chosen to sell Chevron products because they believe the brand will enhance the value of their businesses. On 30 days' notice, they are free to terminate their relationship and choose another supplier.

If open supply legislation passes in Congress, an oil company's service station network will lose its value to the refiner. It will no longer provide a reliable outlet for that company's products. Good business sense may dictate that some companies will abandon the brand. The open supply dealer may have to find another major brand supplier or change to a private brand marketing style. Dealers who lease stations from major refiners may find themselves in a more tenuous situation. They may discover that these companies decide to sell their service stations because they have ceased being reliable product outlets.

Ironically, many dealers may suffer business failure because of a law Congress thought would help service station dealers compete. Proponents of open supply legislation seem to have little understanding of the dynamics of major brand marketing and the problems dealers will face if such laws are enacted.

Recent Changes in Gasoline Marketing

Mr. Jack Houston, Chairman of Government Affairs, Service Station Dealers Association of America: "At this very moment, there are consumers complaining daily who cannot locate essential services with a product. That service is absolutely necessary if this society continues in its posture for the last few years and the economy continues as it is today of mobility being a part of the economy. We must have the ability to quickly service those vehicles along with the network of facilities that provide that product. They are inseparable." p. 150, line 9.

Here, proponents of S.326 charge that consumers are upset because they no longer get proper motor vehicle services. What support is there for this claim? Have Congressmen been flooded with complaints from worried motorists? Have the media reflected a concern over the lack of auto repair facilities? Are consumer groups raising this issue frequently? We believe sponsors of S.326 may be fabricating a crisis to support their claims for divorcement.

Because many full-service stations have gone out of business in the past ten years, or changed their mode of marketing gasoline, there are fewer station facilities available to do repair work. But what effect does this have on today's motorists? In point of fact, consumers have been using gasoline station repair facilities less frequently than they did ten years ago. In part, this is because automotive technology has changed. Automobile parts have greater longevity. Intervals between tune-ups and other routine maintenance work have lengthened.

Inflation has played a role in reducing demand for station services. Many motorists now change their own oil and perform minor automotive work such as changing spark plugs and oil filters. Specialty shops and large automotive centers (not represented by dealer trade organizations such as the SSDA) have taken the place of many service stations by providing convenient and efficient tire and brake service, muffler replacement, transmission repairs, etc. at competitive prices. Auto engines are far more complicated and require specialized mechanical knowledge and sophisticated, expensive equipment for repairs. A key factor influencing the lack of ability of many station operators to provide efficient automotive services is that many have not kept abreast of the developments necessary to accommodate the new technology.

Growth of Direct Service Station Operations by Major Refiners

Senator Grassley (R. IA.): In 1979, a field hearing on this subject was held in my State of Iowa where the Department of Energy figures were presented that indicated that in 1972 approximately 12.5 pecent of all gasoline sold at retail level in this country was sold through refiner-marketer gas stations. The current figures in 1979 show that almost 26 percent of gasoline sold was pumped through the major refiner operated outlets. p. 99, line 24.

At the time of the July 30th hearing, the witness to whom this comment was directed did not respond directly to Senator Grassley's statement. However, the figures presented to Congress by the Department of Energy in its Title III Study[1] show that sales by the 28 largest refiners through their company stores allowed them to increase their market share from 6.6% to 11% from 1972 to 1978. The refiners included in this figure are not just the 16 who are covered by divorcement. DOE's Petroleum Market Shares report shows that the 16 largest of the 28 integrated refiners increased their market share from 4.4% in 1972 to 7% in 1979.

The Title III Report suggests that the greatest growth in volume sold through company stores applies to the smaller refiners, not those impacted by the divorcement provision of S.326.

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[1] The State of Competition in Gasoline Marketing, U.S. Department of Energy, January 1981.

Further the Title III Report points out the annual increase in relative market share for refiner-operated stations in total has been considerably less than the annual increase in relative share for jobbers and unbranded marketers collectively in every year since 1973.

Market Concentration in Utah

Prof. John Flynn, University of Utah: "When you look at regional markets, there is quite a degree of high concentration. For example, in Salt Lake City, we have six refineries. Two of them have the overwhelming share of the market. Those same two control the crude and product pipelines into the market." p. 34., line 13.

Chevron does not have specific data on the Salt Lake market. However, research on the State as a whole (the bulk of the Utah gasoline market is concentrated in the Salt Lake area) indicates that contrary to Professor Flynn's thesis, petroleum marketing is less concentrated now than it was six years ago.

From 1975 to 1981 independent refiners and marketers increased their share of the gasoline market until by June 1981 they sold, either directly to the public or through other sources of distribution, 65% of all gasoline marketed in the State, a gain of 20 points! Integrated majors, through their various sources of distribution now account for only 35% of the state's business according to the Lundberg Market Share Report.

Chevron, one of the two companies that supposedly enjoy an overwhelming share of the Utah market, is the market leader. It sells branded gasoline to the retail trade exclusively through dealer outlets and has a 12% share of the market. During the mid-1970's Chevron operated one (1) Company store in Utah. This unit was subsequently diverted to dealer operation at the end of 1978. The company has had no direct retail operation in the state since that time. If the views of the SSDA and Professor Flynn accurately assess market trends, one would assume Chevron's dealers in Utah, free from the nefarious and predatory takeover tactics of its refiner-supplier, would be in a reasonable state of well-being. Yet, at the present time, Chevron has 103 or 40% fewer dealer outlets operating in Utah than it had in 1976. Surely, to the objective viewer, attempting to understand the contraction in the dealer service station network, something far more fundamental and complex is working in the marketplace than the simplistic theory of the "take-over" myth propounded by advocates of divorcement legislation.

In the state of Utah, the expanding market power of the independents has put pressure on our dealers to increase volume, improve efficiency and adapt to new market realities. Many of our Utah dealers have been successful in this effort. However, a significant number have failed and gone out of business.

Finally, crude oil pipelines, contrary to Professor Flynn's thesis, have little bearing on market concentration ratios because all interstate pipelines, by law, must be common carriers available for all who wish to transport products between states.

SOHIO THE STANDARD OIL COMPANY

1050 SEVENTEENTH STREET, N.W., SUITE 650
WASHINGTON, D.C. 20036

October 30, 1981

The Honorable Strom Thurmond
Chairman
Senate Judiciary Committee
2226 Dirksen Senate Office Building
Washington, DC 20515

Dear Senator Thurmond,

I am pleased to submit the attached testimony by Robert G. Griffin, Vice-President of Marketing for The Standard Oil Company (Ohio), regarding S. 326. Sohio remains opposed to this legislation, which we believe would lessen competition in the gasoline marketplace at a cost to the consumer.

It is noteworthy that in two days of hearings on S. 326, all but one of the parties affected by this legislation spoke out against all or part of it. That one group that spoke in favor is the Sevice Station Dealers of America, the obvious beneficiary of this special interest legislation.

Once again, I appreciate the opportunity to submit this testimony for the record and I would be happy to answer any further questions you or the staff may have.

Yours truly,

Steven A Villas

Steven A. Villas
Associate Director
Federal Government Affairs

SAV/pr

cc: The Honorable Joseph R. Biden, Jr.
Ranking Minority Member
Members of the Committee on the Judiciary

STATEMENT OF
THE STANDARD OIL COMPANY (OHIO)
REGARDING S. 326
OCTOBER 21, 1981

INTRODUCTION

This is a statement of The Standard Oil Company (Ohio) submitted by Robert G. Griffin, Vice President, Marketing, regarding S. 326, entitled "Small Business Motor Fuel Marketer Preservation Act of 1981". Essentially, S. 326 contains the same provisions as S. 2798 on which hearings were held during 1980 and to which The Standard Oil Company (Ohio) submitted detailed testimony on September 25, 1980. SOHIO requests that testimony as well as this condensed statement be made a part of the record in opposition to S. 326.

As introduced, S. 326 would prohibit certain integrated refiners from operating retail gasoline outlets with company personnel; would give a service station dealer the "right of first refusal" to purchase his station if it is offered for sale; would permit open supply under certain circumstances; and would require all classes of trade to be charged the same price at points of transfer if similar quantities of fuel are purchased.

The Standard Oil Company (Ohio) is opposed to S. 326. It is anti-consumer, special interest legislation designed to remove a legitimate competitive force from the marketplace at a cost to the consumer.

Bills such as S. 326 have been initiated to promote the viability of small businesses engaged in gasoline marketing by eliminating purported inequitable practices and competition from their suppliers and refiners. The facts which came to light in the extensive Title III study on competition in the petroleum industry, showed that no inequities other than those created by governmental regulations themselves existed in the marketplace.

Since regulation inequities have been removed by President Reagan's decontrol of the petroleum industry in January, 1981, this legislation can only result in creating new inequities in the marketplace -- protecting dealers at the expense of integrated refiners, jobbers, and others who also compete in the petroleum industry. The result will be a market with less competition, not more, and an industry burdened again with unnecessary and costly regulations.

In addition, S. 326 will result in higher costs for American motorists. It would cut the availability of gasoline during evening and weekend hours, especially in times of tight supply and would reduce the consumer's freedom of choice. If Congress wishes to insulate service station dealers from competition, then the bill should encompass all refiners, jobbers, resellers and wholesalers not just seventeen integrated refiners.

RETAIL STATION DIVORCEMENT

S. 326 was introduced in response to organized dealer allegations that the reduction in the proportion of gasoline volume moved through dealer outlets since 1972 was the direct result of a concerted effort by refiners to eliminate dealers. They contend that refiners have engaged in predatory pricing and have subsidized company-operated stations with profits from other operations.

These allegations do not stand up in the face of facts. The significant decline in the number of service stations during the 1970's was caused by rapidly changing buying patterns of the American motorists as well as basic service station economics. It was not part of a concerted effort by oil companies to eliminate dealers.

By the mid-1970's, consumer buying patterns for gasoline and automotive products were rapidly moving away from predominant use of conventional service stations and gasoline prices had spiraled, slowing the growth in demand. At the same time the cost of running a conventional service station increased substantially as payroll, equipment, utilities, taxes and service expenses soared. Low volume outlets could not cover costs. Direct expenses of 2¢-4¢ a gallon were common for efficient gas-only stations, while costs at full facility outlets were frequently running two to four times those levels. The combination of market segmentation and basic economics resulted in a large number of conventional station closings.

Congress, under Title III of the Petroleum Marketing Practices Act, required the Office of Competition of the Department of Energy to assess the pricing practices of the petroleum marketers. Their study concludes that the decline in the proportion of sales through dealer outlets was the result of changes in consumer preference, not predatory pricing at or subsidization of company-operated stations. Rather, company-operated stations were operating profitably. The report shows that dealers supplied directly by refiners dropped in share of volume 14 percentage points, from 1972 to 1979. In contrast, company-operated stations showed an increase of only 4 percentage points. In fact, the groups which increased their market share significantly during this time were the branded jobbers and the unbranded independents who together increased their share by 13 percentage points.

Sohio's operations, both in Ohio and on the East Coast, are consistent with the Title III findings. The company is not engaged in predatory pricing or subsidization in its company-operated network. In response to a specific inquiry by Senator Howard Metzenbaum, the Justice Department confirmed that Sohio was not engaged in predatory pricing. As stated in a December 6, 1979 letter of Donald L. Flexner, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice:

> We carefully examined these allegations in light of our understanding of the retail gasoline market in Ohio and concluded that they were not sufficient to warrant further inquiry for two reasons. First, Sohio's pricing pattern at both the retail level through company-operated outlets and at the DTW level did not appear to differ in any material respect from those of other refiner/marketers, regardless of their size. Consequently, we saw no reason to believe that Sohio was engaged in predatory pricing aimed at monopolizing the retail gasoline market.

From time to time, Congress has heard stories of alleged predatory pricing from dealers and other proponents of this legislation. Before accepting the credibility of such accusations, several factors should be considered. These stories are usually based on the analysis of one gasoline product price. Most service stations offer three grades of gasoline (and possibly diesel fuel) and either attended service, self service or a combination of attended and self service. As a result, a weighted average of all prices is the only true means of station comparisons. In addition, a comparison of branded and unbranded prices is inappropriate since it does not give consideration to all the costs associated with a branded product.

If company-operated stations are eliminated, motorists purchasing from these stations will immediately pay higher prices for gasoline. A number of surveys have shown that over time, leased dealer stations have been selling gasoline at about 3¢ a gallon above company-operated outlets. Based on current Ohio data, this estimate is conservative. Taking an average differential of 3¢ a gallon and using 60% of the company-operated volume in the U.S. (the estimated proportion impacted by S. 326), customers now buying at these outlets would have to pay about $250 million more per year under dealer operation.

As pointed out in the Title III Study, gasoline marketers adopt different approaches to station operations. These differences result in market competition. Historically, in Sohio's Ohio territory, company-operated stations have played a significant role in Sohio's marketing structure. This is in contrast to the practices of most other refiners. For over half a century, the Sohio brand has retained leadership in the market responding to the buying preferences of motorists with both dealer and company-operated outlets.

The proposed legislation would also reduce the availability of gasoline to motorists during evening and weekend hours, particularly in times of gasoline shortages. Traditionally, company-operated stations have been open longer hours to serve the public than dealer-operated stations. A comprehensive study of hours of operation conducted during May 1981 in Ohio showed that dealers averaged 95 hours per week compared to 114 hours for company-operated stations. Thus, dealers are open approximately three hours less per day. Further, 33% of dealers were closed on Sundays while only 4% of company-operated outlets were closed on that day. In the tight supply period of 1979, Sohio staggered the hours and days of operation at company stations so that many were open on weekends and in the evenings when motorists needed gasoline and when most dealers of all brands were closed. This accommodation would not be possible again if company-operated stations are prohibited.

RIGHT OF FIRST REFUSAL

The "right of first refusal" given to dealers under S. 326 to purchase their stations is not a true "right of first refusal" but rather establishes an unspecified system of appraisal which borders on the bounds of property confiscation. As written, the "purchase right" would probably be consummated through an independent appraisal. The requirements of such an appraisal are to be established by the Small Business Administration (SBA). With the SBA's mandate from Congress it is probable that they will establish sale prices based on the use of the property as a service station. Sohio's experience with service stations divested in connection with the BP merger and other service stations recently sold reveals that non-petroleum use prices are often 2 to 3 times higher than service station values. Thus, rather than creating a more competitive service station market, S. 326 may induce dealers to leave the business after buying their stations at service station values and reselling them at a substantial profit for non-petroleum use. Finally, dealers were already given the "right of first refusal" under the Petroleum Marketing Practices Act.

TRANSFER PRICING

Transfer pricing as required under the bill, will cause hardships to refiners, jobbers, dealers and ultimately to motorists. Transfer pricing will eliminate Robinson-Patman "good faith" meeting of price competition. All refiners do not have the same costs of crude oil, refining or distribution. Essentially, a supplier will be unable to meet competition in a local market without bringing down prices to all customers from a given broad distribution point. This could be highly uneconomical for the supplier. Without help, dealers of this supplier in many markets could become non-competitive and be unable to survive. This could destroy the major brand dealers that the bill purports to assist. Further, the bureaucratic structure necessary to monitor compliance with transfer pricing would be substantial and run contrary to current demand for less government regulation and cost.

OPEN SUPPLY

Open supply, as proposed in S. 326, would cause severe consumer confusion, unfair competition and lead to the demise of branded service station marketing, to the detriment of lessee dealers.

The brand of gasoline is still very important to a large segment of the motoring public. Over the years customers have come to rely on the brand to signify an expected level of product quality, service and other benefits, such as credit card acceptance. This consumer brand loyalty did not develop by chance; it was the result of planned investments in first class service stations at high traffic locations, refinery units, product development, quality control and significant working capital.

Loyalty toward a brand of gasoline is very similar to the loyalty toward any consumer product, such as Maxwell House coffee or Tide laundry detergent. Customers of these brands have developed an expectation of quality and do not expect any surprises when they open a can of coffee, a box of detergent or visit a service station. Although open supply would require the station dispensers to be appropriately marked, motorists would still be attracted to the station by the brand identification on the station building and on the I.D. signs. Having been drawn into the station, the customer would feel deceived by the offering of a product of another brand or no brand at all. His/her confidence in that station and others carrying the same brand would be severely shaken.

Open supply would allow a competitor to take unfair advantage of an established company's trademark/brand loyalty. A competitor could dump product into a station and draw upon the goodwill and investments of the original brand. To protect against revenue declines caused by open supply, the original refiner would have to adjust dealer lease terms in a manner that would be less palatable to dealers. All rentals and franchise fees would have to be established on a fixed "up front" basis.

Overall, the environment created by open supply would make it much less attractive for refiners to make investments in branded service stations.

SUMMARY

In conclusion, a large number of states have rejected retail divorcement, either through inaction or by legislative vote. Since the enactment of the Maryland statute, similar legislation has been introduced in 41 states and in the District of Columbia under pressure from dealer organizations. To date only four other states and D.C. have passed bills. Most states have seen such legislation for what it is: special interest legislation to protect one group of competitors from another, to the detriment of the consumer. Also, substantial efforts are now being made within the Federal Government, by members of both major polical parties, to redefine the role of the government in the marketplace. This trend emerged from strong desires to see market factors operate unfettered by government regulations. Legislation such as S. 326 runs counter to this effort. Petroleum regulations were lifted only nine months ago; it seems inappropriate to invoke new controls; the forces of competition including refiner-operated stations should be given the opportunity to work for the consumer.

STATEMENT OF TEXACO U.S.A., A DIVISION OF TEXACO INC. REGARDING SMALL BUSINESS MOTOR FUEL MARKETER PRESERVATION ACT S.326 AND RELATED BILLS

The following comments are made relative to the S.326 "The Small Business Motor Fuel Marketer Preservation Act of 1981." Texaco appreciates the opportunity to present its views on the subject.

Texaco has been marketing petroleum products since 1902. Texaco's growth since its inception can be credited in large part to its retailers and wholesalers.

Presently, Texaco markets its products through approximately 25,600 accounts, in all classes of trade. Of this number, only 90, or less than 4/10 of 1% are operated by salaried Texaco employes or outside contractors. The Texaco retailers and wholesalers have been and continue to be the lifeblood of Texaco's United States Marketing operations. While Texaco directly operates only a small number of retail gasoline outlets, it must oppose this proposed legislation for three basic reasons: (1) It would deny a segment of industry its fundamental right to operate its business in the most efficient and competitive manner, (2) It will be a detriment to the consumer, and (3) It will not solve the perceived problems of the retailers.

We wish to make very clear that major refiners have not created the problems confronting these retailers. Major refiners have attempted to assist retailers in solving some of the problems they are facing, specifically in aiding retailers to adjust to changing market trends in service and sales. It should be emphasized that this problem is generally demographic, skill related or competitive, based on the activities of other retailers, chain stores and other independent non-petroleum service center speciality shops. Our interests are mutual. If the individual retailer cannot adjust, his loss of business and profits will ultimately adversely impact his supplier and his refiner.

These problems are normal in any competitive business, they are not restricted to gasoline marketing, and represent positive signals that change has occurred. Any competitive market will resolve the issues within its own mechanisms to the degree which the participants respond to the signals and trends. The source of these signals and trends is the preference of the consumer. Therefore, legislation in the name of "fairness" designed to halt this normal process is not in the best interest of the consumer. The DOE so testified at the House Small Business Subcommittee on Energy and the Environment hearing on March 31, 1981 when they stated: "But imposing new restrictions on competition in the name of 'fairness' can be unfair to consumers. Public policy ensures that consumers' interests are protected through competition."

DIVORCEMENT OF SALARY OPERATED STATIONS

The main thrust of this legislation and companion bills, separation of major refiners from direct service station operation is an artificial, forced restructuring device of gasoline marketing which could lead to reduced major refiner owned facilities operated by retailers by prohibiting a major from "pioneering" a new area and location by salary operating to establish its volume potential and profitability, thereby attracting a high calibre retailer to lease it. Higher consumer prices could also result from this proposed Act.

The legislation attempts to deal with the problems of retailer profitability and his continued existence by insulating him from the competitive market to the detriment of the consumer. The FTC also testified before the House Small Business Subcommittee on March 31, 1981 that "There is simply no convincing evidence that franchisees cannot run high-volume operations as efficiently as refiners, who have traditionally not extensively operated retail stations. Some of the most successful non-branded, high-volume operations are run by independent businesses with no affiliation to refiners." Thus, in reality, the legislation attempts to deal with a problem that does not actually exist.

The findings of the completed Title III study of competition in gasoline marketing by the Department of Energy (DOE) entitled The State of Competition in Gasoline Marketing offers substantial support to the position maintained by Texaco and other major refiners that no unfair or discriminatory actions have been taken toward independent retailers by majors, nor have they subsidized refiner operated stations. It also states these refiners are not guilty of predatory pricing.

Section 3(a)(1) of S.326 states ".... it shall be unlawful for any refiner, other than an independent refiner, or a small refiner, to operate any motor fuel service station in the United States." The DOE report, published by the Energy Information Administration, Report on Sales of Refined Products for December, 1980 states in the Survey Methods on page 2: ".... refiners' sales to consumers and to independent marketers consist of a sample of 93 refiners, including the major 15 refiners: Amoco, Atlantic Richfield, Chevron, Cities Service, Continental, Exxon, Getty, Gulf, Marathon, Mobil, Phillips, Shell, Sun, Texaco, and Union Oil of California. These 93 refiners account for over 95% of domestic refining capacity."

The belief that legislation is necessary to prevent the major oil companies, as they are defined by DOE above, from diverting gasoline away from service station dealers and other small businessmen by building up volume at outlets directly operated by the major companies is misdirected. There is no evidence that service station dealers have lost any volume to stations operated by the major oil companies.

The above DOE report reveals in Table 5 and Table 6 under "Sales of Motor Gasoline to Marketing Categories by Large Integrated and Other Refiners," and "Shares of Motor Gasoline to Marketing Categories by Large Integrated and Other Refiners," the following DOE Compiled data:

(1) The 15 large integrated refiner operated retail outlet sales accounted for only 7.0% of that group's total sales in 1980. Sales to that same category accounted for only 4.6% of that group's total sales in 1972.

This represents a change of 2.4% in eight years in sales through major refiner operated service stations relative to total gasoline sales.

(2) Retail sales outlets operated by the 78 other refiners accounted for 26.4% of that group's total sales in 1980. Sales to that same category accounted for 16.8% of the group's total sales in 1972.

This represents a change of 9.6% in eight years in sales through other refiners' operated service stations relative to total gasoline sales.

Not only have Other Refiners increased their percentage of sales through their own company operated stations (9.6% vs. 2.4% for the Majors in eight years), but the total volumetric sales through their own salary operated service stations in 1980 exceeded the total volumetric sales experienced by the Majors through salary operated stations by 2.7 billion gallons (5.3 billion gallons vs. 8.0 billion gallons).

In 1972, Other Refiners through their own salary operated stations sold 4.5 billion gallons, while Majors sold 3.4 billion gallons, a difference of only 1.1 billion gallons.

Therefore, we believe that the records of the DOE reveal the following pertinent conclusions:

(1) Majors continue to sell less in total volume through their salary operations than Other Refiners.

(2) Majors continue to sell less as a percent of total sales through their salary operations than Other Refiners.

(3) Majors' total sales have increased 3.0% in the 1972-1980 time frame while Other Refiners increased 13.9%.

(4) Majors' sales through salary operated stations currently are not significant compared to total sales.

(5) There is no evidence from this data that there is a trend toward salary operated stations by the Majors.

Further examination of the same DOE figures reveals that by comparing 1980 to 1972:

(1) Majors' sales of branded product to open dealers[1/] has decreased 7.0% Other Refiners decreased 12.6%.

(2) Majors' sales of branded product to lessee dealers[2/] has decreased 26.2%, Other Refiners decreased 57.7%.

(3) Majors' sales of branded product to jobbers has increased 54.9%, Other Refiners decreased 12.4%.

(4) Majors' sales of non-branded product to jobbers has increased 90.8%, Other Refiners increased 36.0%.

[1/] Defined as an independent retailer who owns or leases from another party who is not a refiner and is supplied directly by a refiner to a subsidiary of a refiner.

[2/] Defined as an independent retailer who leases from a refiner or a subsidiary of a refiner and is delivered by that refiner or subsidiary.

The DOE data shows that both majors and independents have lost open retailer and lessee retailer volume. The unbalanced allocation percentages for wholesalers reflect regulations which permitted them to increase their market share at the expense of branded and unbranded independent retailers.

In fact the percentages substantiate the restraints which the regulations placed on the retailer class of trade. A factor often overlooked is that non-branded sales to distributors were greatly affected by DOE mandating majors to supply finished product to others in the jobber class of trade. The independent refiner retailer operated outlets generally have suffered to nearly the same extent as those retailers supplied by the majors. Divorcement legislation applied only to the major refiners, as the DOE data indicates, will not solve the retailers problem. The majors, in fact, have fallen behind the salary operated service stations of Other Refiners in terms of total sales, percent of growth, and share of market.

A competitive market, unburdened with regulations, will sort out the most economical and efficient strategies. As a matter of fact, regardless of who led the move to high volume, low margin outlets, it is obvious this strategy has strong consumer appeal. This type of competition will confront retailers whether the legislation is passed or not.

The retailer response to the condition cannot be legislated. Divorcement legislation ignores the fact "consumer appeal" for low margin outlets is changing the market. It attempts to freeze relationships in the market in an effort to protect some individuals from the competitive forces within the market.

AFFECTS ON THE CONSUMER

Analysis of divorcement by other groups outside of the industry have indicated the consumer will suffer economically if divorcement is passed. Professors L. M. Lamont and C. F. Phillips, Jr. of Washington and Lee University conclude in their study that divorcement could "... result in higher gasoline prices and less convenience for the consumer."[3/] Two other professors, Mr. C. E. Krider and Mr. Eric L. Richards, of the University of Kansas believe that "... the price of such an end will be high to consumers."[4/] Finally, the Petroleum Industry Research Foundation, Inc.[5/] has concluded that the result of passage would be a less competitive market with higher gasoline prices.

[3/] L. M. Lamont and C. F. Phillips, Jr., The Gasoline Market: An Analysis of Retail Divorcement, January 1979, p. 48.

[4/] C. E. Krider and E. L. Richards, An Analysis of Petroleum Industry Divestiture Legislation, January 1979, p. 36.

[5/] The Impact of Gasoline Service Station Divestiture, Petroleum Industry Research Foundation, January 1979.

In reflecting on legislation, the observations of former Assistant Attorney General John Shenefield of the Antitrust Division of the Department of Justice should be emphasized. His January 1979 testimony before the Virginia Legislature regarding divorcement supports contentions that legislation such as S.326 is anti-consumer, anti-competitive, and unnecessary.

Mr. Shenefield's observations that government must constantly be on guard against passing laws and regulations which, "... inhibit competition by placing the interest on individual competitors above the interest of all consumers," reinforces the belief that only a small number of individuals would benefit from divorcement at the expense of all other consumers whom it would injure or penalize economically.

Indications are that the proposed legislation would be costly to the consumer. Virtually all studies and analyses of divorcement state the consumer would be economically penalized by its passage. Even the pro-divorcement reports do not indicate any possible consumer benefits would be derived from the passage of divestiture legislation. How will the American consumer and consumer advocates respond to the imposition of this radical change and probable economic burden?

The consumer is the basis of business for all facets of the petroleum industry -- the refiners, the wholesalers, and the retailers. Any industry, regardless of its end product, must be willing to adapt to consumer needs. We all entered with the intent of being successful by satisfying consumer demand. The proposed Bill and related divorcement legislation would attempt to stop and reverse this natural process.

With the proposed elimination of a competitive factor of the market (refiner operated stations), consumers could find themselves in a position where one of their alternatives will no longer exist.

WHOLESALE TRANSFER PRICING

We oppose legislation mandating a supplier to sell motor fuel at the same price to all classes of wholesale purchasers, at any particular supply point, especially when this legislation ignores market conditions and the differing functions purchasers might serve in the market.

Before price controls, there were scattered reports of various suppliers in various areas testing or otherwise trying a single pricing arrangement. Even with controls (which placed severe cost recovery penalties on such arrangements) there were indications that a modified single price arrangement in the Bakersfield, California area had been tested.

While the regulations effectively prohibited suppliers from utilizing single pricing arrangements, with decontrol, it is now entirely possible some suppliers in some areas would adopt some form of rack or wholesale transfer pricing. It is our understanding that several large refiners have instituted various types of rack pricing since January 28, 1981. It is very possible that the market will adopt this pricing method.

Legislative imposition of wholesale transfer pricing, is unnecessary. We believe the market will eventually dictate some type of rack or origin pricing, if such is proven to be competitively appropriate. Legislation would only serve to distort and complicate what would otherwise be an orderly market transition. The previously mentioned Title III Study of the Petroleum Marketing Practices Act clearly show there is no evidence that the Majors are subsidizing their salary operated stations. Therefore, this portion of the proposed Bill is unnecessary.

OPEN SUPPLY

The question of open supply could cause innumerable problems for retailers, wholesalers and consumers. Although companion provisions allow for a reasonable surcharge for refiner provided benefits, and also provide that reasonable notice at the point of sale be given to purchasers of such motor fuel that it is not provided by the refiner, the costly administration of these unnecessary provisions will apparently be borne by the refiner. Consumers would no longer be able to determine what quality products are available from the trademark signs of outlets at a glance. They would have to enter a station before they could discover whether the anticipated product is available. In essence, the right to purchase, store, and sell any available product will subject the consumer to a form of fraud. The trademark sign implicitly indicates the refiner's products will be available, and when they are not, the consumer has been deceived.

Quality of product manufactured could easily fall to the minimum standards. Open supply could remove all incentives to insure a quality product, or continued research to develop more efficient fuels. Brand integrity could become relatively unimportant as refiners would be unable to determine with any reasonable accuracy where or to whom the product will ultimately be sold. The retailers and wholesalers who would choose to operate outside their normal supply arrangements could anticipate consumer confusion, probable mistrust, and erosion of personal confidences.

Investment service stations owned by the refiner or owned by others and leased back to refiners, for operation by retailers or wholesalers might disappear as a class of trade. Continued investment in rehabilitation of existing outlets or new construction in growth areas by refiners might cease. The open supply provision eliminates any incentive for refiners additional investment at existing or new sites.

SUMMARY

The proposed Bill will not remedy a confused marketplace which has been created by previous legislative and regulatory restrictions. Market restructuring has certainly occurred, but it has been achieved through the classic economic evolution of supply and demand, and the resultant profit and losses. In other words, in a competitive system, restructuring is a continuing process, but it is a natural process-- one which should not be legislated into existence. The proposal omits the catalyst of meaningful and realistic marketing changes--the American consumer.

Legislation exists today in the form of antitrust laws and the Petroleum Marketing Practices Act, to preserve the independent marketer segment of the gasoline retail market. With the adequate protection these laws afford retailers, we question the need for what appears to be redundant legislation, especially since the proposed Bill will apparently penalize the consumer.

Any special interest legislation is always questionable. In this case, we would question whether in fact the "special interests," the independent retailer, this legislation is designed to protect, would even benefit. Certainly, the public as a whole will not.

Any regulation, no matter how well intended, which further alters normal evolving marketing conditions is also questionable. This proposal would not be in the public interest because it is anti-competitive and would increase consumers cost unnecessarily. It would eliminate other benefits of company operated outlets presently enjoyed by American motorists.

The market must be given time to balance itself after almost nine years of cumbersome and counterproductive regulations. It would be a grave mistake to ignore the lessons visibly shown to us during that time by immediately passing legislation that meddles in the open market.

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CITGO

COMMENTS OF CITIES SERVICE COMPANY ON S. 326

I. INTRODUCTION--PROFILE OF CITIES SERVICE COMPANY

Cities Service Company is a vertically integrated mid-sized oil company. Cities Service produces approximately 90,000 barrels of crude oil per day. The company's refinery, located at Lake Charles, Louisiana, has a current capacity of 291,000 barrels per day. When this refinery is operated at full capacity, it is necessary for the company to purchase about 200,000 barrels per day of crude oil or about 70% of the company's requirements. While a large portion of this crude oil is purchased under contract, most contracts are for periods ranging from one month to one year and are subject to price fluctuations. Therefore, most of the company's crude oil supply is subject to nearly the same price vulnerability as if it were purchased in the spot market.

Because of this vulnerability, Cities Service must have secure channels of distribution for its refined petroleum products. Between 55% and 60% of the refinery's output, or about 165,000 barrels per day, is gasoline. Cities Service would be placed in an untenable position if legislation were enacted that would eliminate a significant portion of the company's retail marketing operations and thereby force the company to sell gasoline only on a wholesale basis. As a consequence of such legislation, the company would be exposed to the uncertainties and increased risks of the commodity markets for both the costs of its crude oil and the revenues from sales of its refined products. If legislation were enacted that would prohibit the company from engaging in direct retail marketing of gasoline, it would affect the capabilities and viability of Cities Service's entire gasoline marketing operations.

Approximately 75% to 80% of the company's gasoline is sold to branded and unbranded distributors who are independent marketers and who, in turn, sell to dealers, or directly to the motorist through their own operated stations.

The remaining 20% to 25% of the company's gasoline production is sold by the Retail Division through employee operated stores, independent convenience food stores and dealers.

At the present time, CITGO brand gasoline is marketed through 316 Quik Mart convenience stores. These facilities feature an efficient layout that enables one cashier to handle sales of gasoline, convenience foods and other items. Consumers can generally enjoy competitively priced gasoline and other products at these stores because of their efficiency. Quik Mart stores are located in 18 states and employ approximately 2500 store managers and retail clerks.

Approximately 5,000 dealers also market CITGO gasoline. Most of these dealers are served by CITGO distributors. Approximately 300 dealers are served directly by the Retail Division and most of these are located in the northeastern part of the United States.

II. RESPONSE TO PRICING CONCERNS

Before outlining the basis for Cities Service's opposition to S. 326, and the divorcement provisions of the bill in particular, Cities Service believes the concerns expressed by several Members of the Committee during the hearing on this legislation are so important as to warrant special response.

During the hearing, several Senators inquired regarding allegations which they had received that refiner operated retail outlets were selling gasoline at a pump price equal to or less than the wholesale price at which the refiner sold gasoline to a competing lessee dealer station. Similar charges have been made in the past.

Without suggesting that other refiners have engaged in the alleged pricing practice, Cities Service does believe it appropriate to note that none of these allegations have been directed at Cities Service. The nature of Cities Service's wholesale pricing program (described more fully infra at 14) guards against the possibility of such occurences in the case of the company's employee operated Quick Marts.

More generally, it should be noted that by their very nature, these allegations call upon refiners to prove the negative, i.e., that they are not pricing in the alleged manner. Of course with tens of thousands of lessee dealer stations and thousands of employee operated retail outlets this is an impossibility as long as the allegations remain vague, nonspecific and undocumented. There are, nevertheless, a number of general considerations which Cities Service believes the Committee should consider in determining the weight to be given such allegations.

First, prior to gasoline decontrol, any instance of such pricing may have been the result of the requirements of the immensely complex DOE price control regulations applicable to refiners, particularly the "equal application" and "class of trade" rules. Cities Service believes that in considering whether to enact S. 326 in the current post-decontrol environment, the Committee should not be influenced by pre-decontrol pricing aberrations caused by price controls. Rather the Committee should evaluate the need for new legislation based upon post-decontrol market conditions.

Second, historically many allegations of unfair pricing practices by major refiners have not withstood even cursory examination. Often it has turned out that allegations against a major refiner operated retail outlet were in fact directed at an employee operated outlet of another type of marketer. Similarly, allegations against major refiner operated retail outlets have in some cases actually compared the pump price of the refiner operated retail outlet with the wholesale price of gasoline sold by another supplier (and not the refiner) to a competing dealer. Of course in such cases the refiner has no control over the wholesale price charged by the other supplier to its dealer. Commonly, the major refiner is meeting retail price competition. The dealer's problem is thus not due to the retail pricing practice of the major refiner operating the retail outlet but the wholesale pricing practice of the other marketer supplying the retail dealer. This type of economic problem is inherent in our system of competitive free enterprise.

Third, it is impossible to assess the competitive impact of any such allegation without considering the specific circumstances, including the pricing of other competitors and whether the refiner operated retail outlet in fact "competes" with a dealer operated outlet.

Finally, Cities Service believes it is essential that those who would justify divorcement legislation, such as S. 326, based upon allegations of unfair refiner pricing practices must properly bear the burden of documenting the basis of such allegations. Moreover, those making such allegations should also bear the burden of demonstrating that the examples cited are not isolated aberrations but rather are part of a comprehensive pattern of unfair retail pricing by refiners. Nothing less would justify so broad a legislative response as divorcement proposed in S. 326.

III. HISTORY OF GASOLINE MARKETING

Gasoline marketing divorcement legislation is an effort to address the problems of retail gasoline marketers. The problems of the retail gasoline marketer in the 1980's, however, are rooted in the history of gasoline marketing. Any serious effort to determine whether divorcement legislation will provide a solution to these problems requires at least a brief review of that history.

Period of Growth

During the 1950's and 1960's gasoline marketing in the U.S. experienced unprecedented growth. The post-war boom was in full force: the 40-hour work week provided Americans with increased leisure time; expansion of the interstate highway system prompted increasing numbers of Americans take to the road. After the experience of the 1930's and 40's, during which the number of automobiles remained virtually unchanged at 25 to 30 million, who would have believed that by 1968, 100 million vehicles would be in use? Who would have guessed that Americans would travel a trillion miles and consume 106,000,000,000 gallons of gasoline in a single year?

The response of petroleum marketers to this expanding market was natural. Real estate departments of major refiner-marketers became the focal point for executing most marketing strategies. Getting the best location on the corner became the prime goal although often just getting any corner on a prime intersection was critical to marketing success. Everyone found a way to get a piece of the action. Major branded marketers increased the number of their branded retail outlets. The number of lessee dealers participating in retail gasoline marketing increased rapidly. Nonbranded independent marketers found that price competition could be an effective marketing technique. By offering a two-cents-per-gallon discount from the price charged at major branded outlets, unbranded independent marketers increased their aggregrate share of the market from less than 20 percent during the 1950's to more than 30 percent by the early 1970's.

During this same period, relatively low volume conventional service stations, usually operated on a full service basis, could operate economically. Automobiles required regular maintenance at relatively short intervals. The days of reduced maintenance, of radial-ply tires, sealed batteries, synthetic motor oils, unleaded gasoline (which reduces spark plug corrosion and fouling), and electronic ignitions were still on the distant horizon.

Cities Service's Marketing Activities--Response To Change

During this period, Cities Service marketed gasoline through dealers, distributors, station consignees, and employee operated facilities. To keep up with the intensive competition in gasoline marketing, Cities Service undertook a number of major marketing activities.

Cities Service established substantial capital budgets for site acquisition and facility construction to increase the number of retail outlets in order to satisfy growing demand and to increase the company's brand acceptance. Twice the company changed the design of its retail marketing facilities in order to keep pace with its competitors in providing modern facilities that would appeal to the consumer. The company financed substantial advertising campaigns designed to increase consumer awareness of the Cities Service brand. The company expanded its credit card program to encourage regular use of its facilities. Cities Service implemented dealer recruitment and training programs in an effort to develop consistently high quality service station operations which would attract consumers. Cities Service even changed its trademark to "CITGO"--a name believed to have more consumer appeal.

Regrettably, all of these activities failed to produce the results Cities Service hoped for--increased market share which would translate into improved earnings. Cities Service continued to be hampered by low volume retail outlets, high dealer turnover, and poor return on its investment. In retrospect, it is clear that these problems were due to a lack of brand acceptance which prevented the company from competing directly with major branded retail marketers such as Exxon, Mobil, Texaco, and Shell. On the other hand, the inefficiencies of the company's franchised operations and the rigidity of dealer tank wagon pricing prevented Cities Service from competing aggressively with nonbranded independent marketers for the gasoline dollars of price-conscious consumers.

At one point Cities Service embarked on a strategy designed to improve its retail marketing performance by acquiring the best retail gasoline marketing sites available. It was believed that such an aggressive acquisition program would improve the company's brand recognition and thereby increase its gasoline sales. To assist in the implementation of this strategy, Cities Service purchased a proven computer program called "The Service Station Strategy Model". This model provided the company with a new tool for analysis of prospective retail marketing sites.

Cities Service's first experience with the Strategy Model was in Baltimore, Maryland. The Strategy Model contained data on the gasoline marketing facilities of Cities Service's competition, including the type of facility and the number of pumps; data regarding the entire arterial highway system of Baltimore, including traffic counts; data regarding all traffic generators such as shopping centers, interstate highway interchanges, industrial parks, etc.; complete population statistics, including housing counts and the number of cars per household; formulas representing national brand acceptance of Cities Service's competitors based upon the number of outlets and advertising budgets of these competitors; and observed gasoline prices of each competitor. Utilizing the Strategy Model, Cities Service could establish the potential of each competitor as well as that of Cities Service itself for any given location. The model gave the company the capability of simulating the performance of a new CITGO outlet at any given location.

Based upon these simulations Cities Service developed a real estate acquisition plan for the entire Baltimore area. Using the computer projection of the company's potential gasoline sales and the construction cost of the service station facilities, Cities Service was able to calculate the amount it could pay for the land and still receive an acceptable return on its investment. The company's real estate department, however, found there were few, if any, sites which Cities Service could afford to purchase in the entire city of Balitmore because the land costs exceeded the amount Cities Service could pay and still earn an acceptable return. The alternative uses to which the land could be employed, including as a service station of a major branded marketer with greater brand recognition, were more economic than a new CITGO service station. To the company's dismay, this same condition was found to exist in other market areas.

It became clear that in order for Cities Service to continue to exist as a retail gasoline marketer, the company had to develop a new approach to retail gasoline marketing. Computer simulation had demonstrated that Cities Service could not compete on the same basis as major branded gasoline marketers.

A new marketing approach was developed by Cities Service with the object of responding to new consumer demands. This marketing strategy was built around a new facility called a "Quik Mart" featuring a unique design which offers consumers gasoline at a competitive price and the convenience of purchasing miscellaneous household items and foods. These facilities have been successful because their operation is characterized by low operating costs and centralized management controls.

Today, almost ten years after initiation of the Quik Mart operations, these stores are still unique. They serve the needs of a specific sector of the gasoline market and provide a satisfactory return to Cities Service. These stores are company operated.

New Marketing Strategies

It is noteworthy that other integrated refiner-marketers of gasoline also adopted innovative marketing strategies to compete with the larger, better-known major brand refiners such as Exxon, Texaco, Shell, Mobil, Chevron, Gulf, Amoco and Arco. These latter refiners enjoyed far greater brand recognition than their mid-sized integrated refiner competition, including Cities Service. Like Cities Service, several of these mid-size refiners adopted new marketing strategies to enable them to compete with their better-known competitors. For example, Union carved out a dominant position in the truck stop field. Sun developed a unique blending pump which permitted it to offer a wider range of octane grades and to be price competitive by offering reduced octane gasoline at a discount from the price of the next higher grade. Others experimented with direct marketing through gas-only outlets operated by employees.

It is clear that none of the innovative marketing techniques of these refiners was motivated by predatory desires. Rather such innovation was the result of the inability of these refiners to compete on the same basis with the larger major brand refiners and the need for these refiners to adapt to changing marketing conditions in order to survive as retail gasoline marketers.

The Automotive Service Revolution

At the same time as market forces, including poor brand recognition and low market share, were compelling Cities Service and other mid-sized refiners to modify their marketing strategies, other forces were reducing the number of retail gasoline outlets.

The typical retail gasoline outlet of the 1960's was usually a two or three-bay station with facilities to perform routine maintenance service, tune-ups and mechanical work on automobiles. It also had space available for maintaining an inventory of tires, batteries, and other automotive accessories (TBA) which were most frequently needed by motorists. The outlet also had gasoline available for sale. In short, the "typical" retail gasoline outlet offered to the consuming public what the public wanted and needed. Sales of TBA and automobile services supplemented gasoline income, making a large number of low volume retail gasoline outlets economically feasible.

In the 1950's the American automobile had a recommended oil change and lubrication interval of one or two thousand miles, and for sake of convenience most motorists elected to have this recurring service work done at the local service station where they bought their gasoline. When the time came to replace worn tires, tune the car, or replace the anti-freeze, the local service station was also the choice of many consumers.

It was a common belief of many retailers that "you make your expenses at the gas pump and your living in the service bays."

While many individual gasoline retailers were devoting their time and resources to maintaining or increasing the automotive service part of their businesses, a revolution was taking place. There were no shots fired in this revolution; however, the results were as dramatic, in terms of ultimate casualties, as if a full-fledged war had been waged.

Over a period of years, almost unnoticed, an attack was being launched on the retailers' bread and butter. American and foreign cars became more and more sophisticated, while simultaneously needing less and less routine maintenance. Solid state ignition systems, long-life sealed batteries, improved motor oils, and new compounds for belts and hoses reduced the need for routine maintenance and, thereby, the income of the operator of the conventional full service station.

While routine maintenance requirments declined, the increasing complexity of newer autos tended to direct more of the maintenance work that remained to specialty shops and automobile dealers equipped with the specialized equipment needed to properly service sophisticated, modern automobile engines. Mandated environmental and fuel efficiency standards for new vehicles made the essentially-simple internal combustion engine an enormously complex device requiring expensive, sophisticated equipment for proper diagnosis of its problems as well as routine maintenance. Many retailers did not have the financial resources to purchase this space-age technology. The automobile dealer service shops with their larger capital resources captured a great deal of automobile tune-up and repair work which had previously belonged to gasoline retailers. The decline of this service business destroyed the economic viability of many full service dealers.

New Competitors For The Motorist's Service Dollars

In the final analysis, however, it was not technology alone which conspired against gasoline retailers. Other factors contributed to the changing economics of gasoline retailing, including the competitive influences of franchise operations for mufflers, tires and brakes, discount automotive supply stores for the do-it-yourself mechanic, tune-up specialty shops and automotive service centers operated by large retail department stores.

When tires lasted 10-12,000 miles and were relatively inexpensive, the motorist often found it convenient to purchase them at his local, conventional service station. The advent of 40-50,000 mile radial-ply tires, and the substantial initial cost of a set of such tires, changed the economics of such purchase decisions. Shopping around could be worthwhile as the price, and potential savings, increased. So, too, in the case of batteries. When a battery needed annual replacement and was a relatively small purchase, the motorist was more inclined to purchase it at a local, conventional service station than when the battery would last the life of the car but involve a more substantial initial expenditure. Other examples can be cited; all underscore the reality that an important supplemental source of income to the operator of a conventional retail gasoline outlet was declining.

Self Service Gasoline

Moreover, gasoline marketing itself (as distinguished from the operation of a service station) was undergoing fundamental change. In the last 10 years, the motorist has clearly indicated his desire to purchase gasoline at the lowest possible price. The motorist has demonstrated a willingness to tolerate the inconvenience of pumping his own gasoline if that will save him money. Indeed, all indications are that today's motorist is concerned with saving both time and money, a result achieved by utilizing the self service retail outlet of the 1980's.

OPEC

Just as changing market conditions were coming to bear on retail gasoline marketing, a fundamental revision in gasoline pricing and supply began. Before it was completed, the economics of world oil markets in general, and those of U.S. gasoline markets in particular, would be fundamentally changed. As the price of gasoline soared, consumer sensitivity to the price of gasoline also rose.

The events of the 1970's also included serious supply interruptions which had the effect of alerting motorists to the essentially fungible nature of gasoline. This new awareness reenforced the motorists' awakening price sensitivity.

IV. FEDERAL REGULATION OF GASOLINE MARKETING

No recounting of the recent history of retail gasoline marketing can be considered complete if it does not account for the price and allocation regulations of the 1970's. These regulations were originally designed to cope with the dramatic price increases and supply interruptions which accompanied the 1973 Mid-east war.

While the pricing regulations justifiably share a responsibility for the adversities suffered by gasoline retailers, the allocation regulations were far more damaging. There is ample reason to believe that the allocation regulations were the cause of more retail gasoline outlet closings since 1974 than all other reasons combined.

In January 1974, in the midst of what is generally referred to as the Arab oil embargo, the Federal Energy Office (one of several predecessors to the Department of Energy) implemented an allocation program for motor gasoline. This program was designed to distribute the scarcity and equalize the misery. It was marginally successful during and for a short time after the embargo. However, when its primary purpose was achieved and a period of adequate supplies returned to the marketplace, these regulations continued to govern the distribution of petroleum products. Retail marketers, confronted with the growing decline of TBA and service revenues, found that their economic survival now depended on innovative marketing strategies to increase gasoline sales. Unfortunately, the regulations permitted an allocation of gasoline based on purchases during calendar year 1972. These volumes were generally inadequate to permit the increased gasoline sales necessary for many retailers to remain economically viable.

In theory there were administrative remedies available. The reguations provided a mechanism whereby application could be made for increases to base period allocation volumes. Many retailers made use of this mechanism. However, the administrative relief authorized in the regulations was more illusory than real where existing retailers were concerned. There existed an institutional bias within the Federal Energy Administration (FEA) against applications from existing retailers. Applications from existing retailers, when acted upon at all, were routinely denied in all Regional Offices. At the same time, the allocation regulations provided that jobbers could apply to FEA for increased allocations for new retail outlets. By simply notifying their prime suppliers, jobbers were furnished the additional gasoline needed to serve new outlets on an interim basis pending FEA Regional Office approval of the application. Published agency guidelines contained a presumption in favor of increased allocations for new retail outlets and it followed that such applications were almost always approved.

In July of 1980, Cities Service, in testifying before the Economic Regulatory Administration of the DOE regarding a revision to the motor gasoline allocation regulations, noted:

> Existing retail outlets have for too long been excluded from the opportunity of sharing in the growth in the marketplace as a result of changes in demand patterns or other similar growth situations. Cities Service believes that equity demands that existing retail outlets be evaluated for adjustments in their base period entitlements under the same standards as are applied to applications for new retail outlets.

Retailers who tried to address the dynamics of changing consumer buying habits by changing their marketing methods were precluded from doing so. Without the additional gasoline needed to respond to new market conditions, there was no longer any future in gasoline retailing for many individual retailers.

It should be recognized that the inevitable consequence of consumer preference for cheaper gasoline was higher volume outlets at which the per gallon retail markup to cover the cost of retailing could be minimized. However, as each station pumped larger volumes, either total consumption had to increase dramatically or the number of outlets had to decline. Reduced demand as a result of higher prices and conservation prevented the former and assured the latter. Although federal gasoline price and allocation controls focused a disproportionate share of the overall reduction in outlets onto retail dealers, it is clear that an overall decline in the number of conventional outlets was inevitable. And, since most conventional outlets were dealer operated to begin with, the reduction in the ranks of the retail dealer could not be avoided.

Given the real cause of the decline in the number of retail dealers, it is unfair to attribute this phenomenon to forward integration by refiners into retailing. The growth of refiner operated retail outlets has been simply too small to account for the decline in the number of retail dealers. Nor will retail gasoline marketing divorcement stem this decline.

V. DOE TITLE III STUDY

The foregoing conclusions are also supported by a detailed study of gasoline marketing conducted by the Office of Competition of the Department of Energy. This study was mandated by Title III of the Petroleum Marketing Practices Act, P.L. 95-297. The study culminated in a two volume Report. The key findings of the Title III Report are as follows:

(1) There has not been a massive movement by refiners into the direct retailing of gasoline. Based upon a detailed analysis of nationwide and statewide trends, a handful of refiners, in limited marketing areas, were found to account for the present movement of refiners into the direct retailing of gasoline.

(2) No evidence was developed from a detailed analysis of five major marketing areas--Atlanta, Boston, Fort Wayne, Houston, and Los Angeles, using a variety of analytic techniques, that refiners are subsidizing the sale of gasoline at retail as part of a predatory campaign. To the contrary, the Title III Report found that such sales are made for pecuniary reasons and not for predatory reasons. When viewed in light of the increase in sales of gasoline to independent marketers collectively, this conclusion was found to be unavoidable.

(3) Changing economic and marketing conditions were found to be primarily responsible for the movement to high volume, self service stations and away from the low volume, full service network. Changing consumer preferences, increasing operating and construction costs, changing expectations of developments in crude oil markets, and competition from highly efficient independent marketers were the driving forces behind these changes. The Report also concluded that under the regulatory system developed in the 1970's, dealers as a group may have been unable to participate in the trend to higher volume outlets.

(4) The price and allocation regulations of the Department of Energy were the most anticompetitive factors operative in the gasoline market and were a driving force behind the trends analyzed in the Title III Report.

The data relied upon by DOE to support the Report's conclusions was voluminous. Among this data, however, are certain critical statistics which, when presented graphically, demonstrate the basis for Cities Service's opposition to divorcement legislation and the basis for the findings of the DOE Title III Report.

Figure 1 represents the average monthly volume per dealer for various classes of retail gasoline dealers in 1972 and 1978. Figure 1 confirms the previously described experience of Cities Service. In 1972, the average monthly volume of Exxon, Amoco, Shell and Texaco (Group I) dealers was substantially greater than that of all other dealers. Similarly, with the exception of the Group I dealers, the average monthly volume of Gulf, Mobil, Arco and Chevron (Group II) dealers was significantly greater than that of all other dealers. Among the lowest volume dealers were those of Marathon, Conoco, Ashland and Cities Service (Group IV). This confirms Cities Service's experience that its dealers were not economically viable competitors.

Figure 1 also indicates that, generally, by 1978 average monthly volume per dealer had increased significantly--fewer dealers sold greater volumes per dealer. The relationship between dealer groups in 1972 continued, moreover, in 1978. Noteworthy, however, is the fact that unlike the Group I, Group II and Group III dealers, the Group IV dealers alone experienced a decrease in average monthly volume per dealer. Clearly the economic squeeze experienced by the Group IV dealers worsened under price controls and dramatic action was called for if their refiner-suppliers were to survive as potential competition to the largest 8 refiners in Groups I and II.

Figure 2 indicates that over the period 1972-1978 the number of outlets operated by the 16 largest refiners who would be affected by the divorcement provisions of S. 326 increased by only 235 outlets. This increase can hardly account for the far larger decline in the number of dealer operated retail outlets. Figure 2 graphically demonstrates that the divorcement provisions of S. 326 are misdirected--growth of direct retail competition with dealers through operated retail outlets of major refiners is not the problem the dealers have painted it to be.

Figure 3 confirms this conclusion and suggests another basis for the dealers' complaints. Figure 3 presents a chart of gasoline market share over time for three classes of marketers--refiner retail and direct sales, dealer sales and independents and branded and unbranded jobber sales. Significantly, refiner market share over the period remains virtually unchanged. Dealer market share, however, declined substantially while jobber market share experienced a corresponding increase.

FIGURE 1

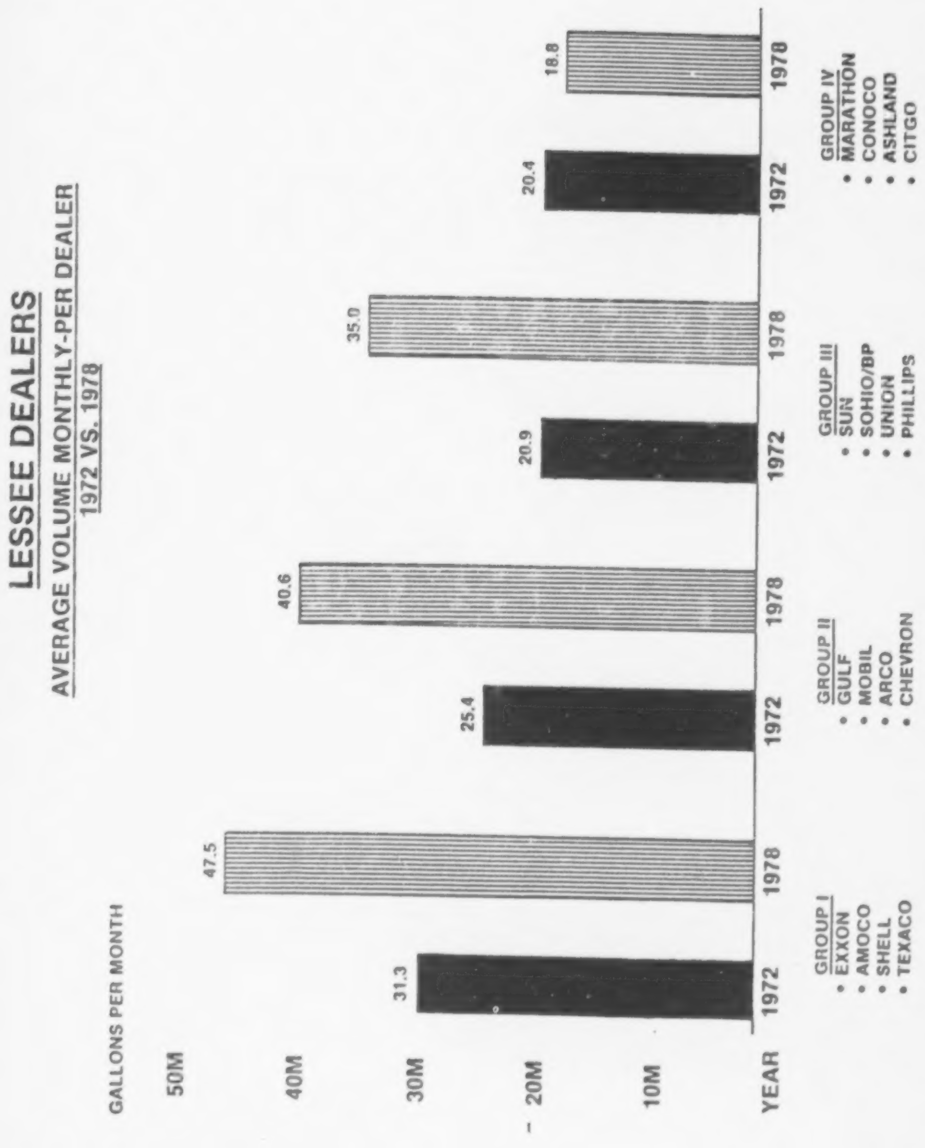

LESSEE DEALERS
AVERAGE VOLUME MONTHLY-PER DEALER
1972 VS. 1978
GALLONS PER MONTH
50M
40M
30M
20M
10M
YEAR
1972
31.3
1978
47.5
GROUP I
• EXXON
• AMOCO
• SHELL
• TEXACO
1972
25.4
1978
40.6
GROUP II
• GULF
• MOBIL
• ARCO
• CHEVRON
1972
20.9
1978
35.0
GROUP III
• SUN
• SOHIO/BP
• UNION
• PHILLIPS
1972
20.4
1978
18.8
GROUP IV
• MARATHON
• CONOCO
• ASHLAND
• CITGO

FIGURE 2

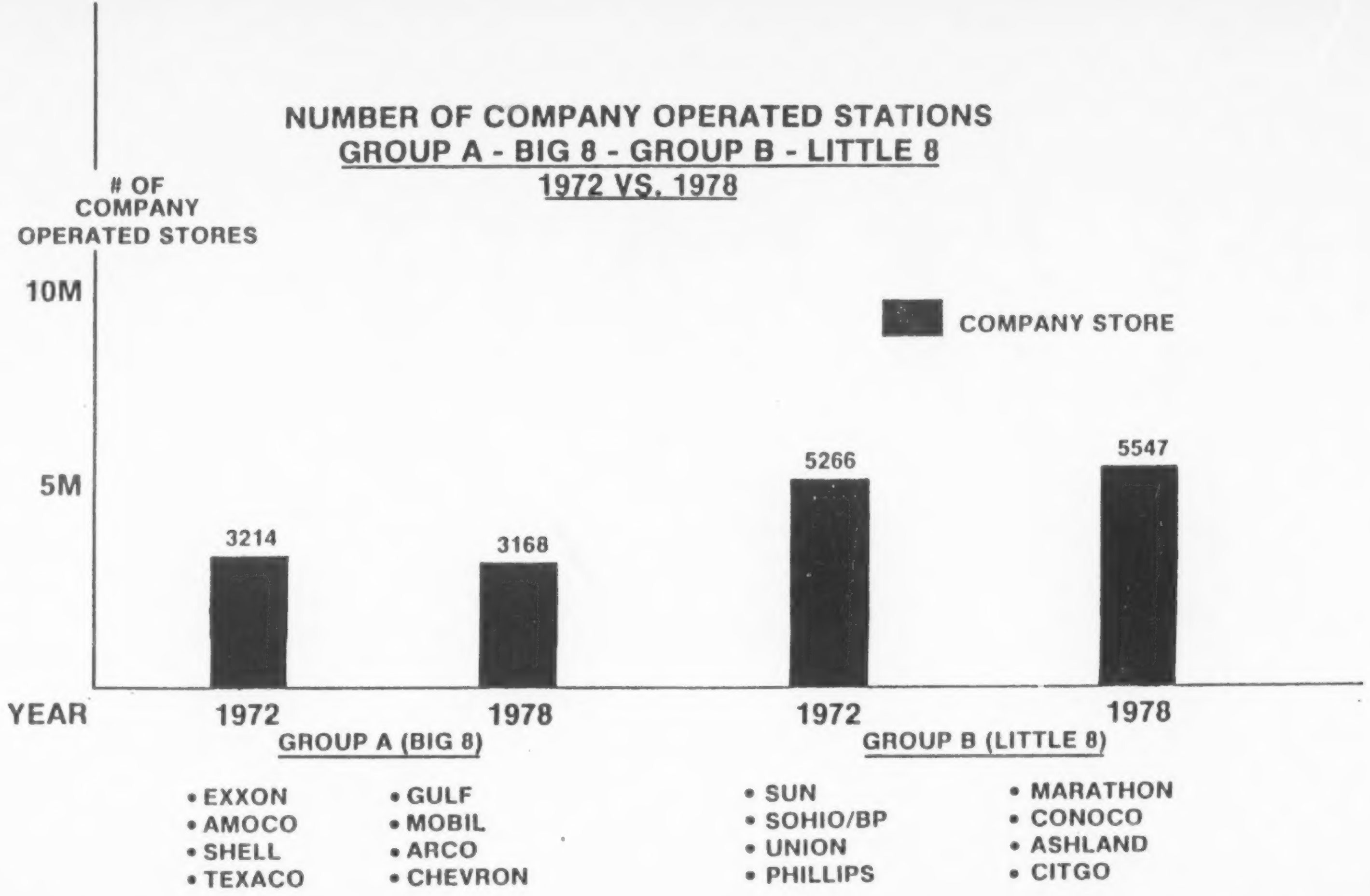
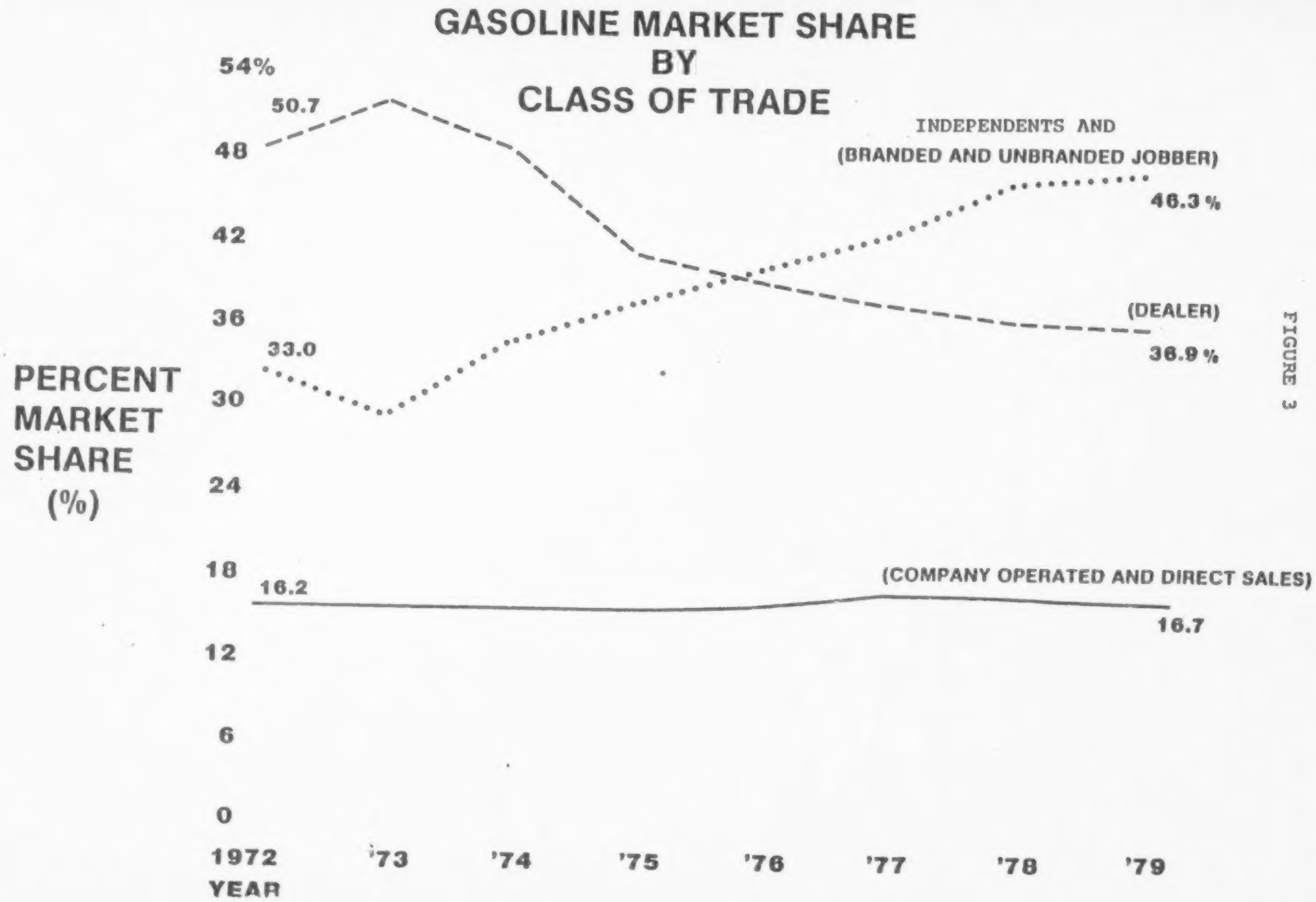

NUMBER OF COMPANY OPERATED STATIONS
GROUP A - BIG 8 - GROUP B - LITTLE 8
1972 VS. 1978
# OF COMPANY OPERATED STORES
10M
5M
YEAR
COMPANY STORE
3214
3168
5266
5547
1972
1978
1972
1978
GROUP A (BIG 8)
• EXXON
• AMOCO
• SHELL
• TEXACO
• GULF
• MOBIL
• ARCO
• CHEVRON
GROUP B (LITTLE 8)
• SUN
• SOHIO/BP
• UNION
• PHILLIPS
• MARATHON
• CONOCO
• ASHLAND
• CITGO

FIGURE 3


GASOLINE MARKET SHARE
BY
CLASS OF TRADE
PERCENT
MARKET
SHARE
(%)
54%
48
42
36
30
24
18
12
6
0
1972
YEAR
'73
'74
'75
'76
'77
'78
'79
50.7
33.0
16.2
INDEPENDENTS AND
(BRANDED AND UNBRANDED JOBBER)
46.3 %
(DEALER)
36.9 %
(COMPANY OPERATED AND DIRECT SALES)
16.7

VI. CITIES SERVICE'S RETAIL MARKETING POLICIES

Although the history of gasoline marketing clearly demonstrates that the decline in the number of retail gasoline outlets has been the result of changing market conditions, and the DOE's Title III Report found no evidence that this decline was attributable to a predatory campaign by refiners, concerns continue to arise regarding the fate of gasoline retailers. Cities Service shares these concerns. In response to these concerns Cities Service has initiated a number of innovative marketing policies designed to provide maximum flexability to, and enhance the competitive ability of, CITGO retailers.

Rack Pricing For CITGO Marketers

Cities Service sells gasoline to all distributors and franchised dealers on a terminal-rack price basis. This price represents the market value of the gasoline plus distribution costs, including terminal expense. CITGO and bank credit cards are available to CITGO marketers on a no charge basis. Gasoline is transferred to the Retail Division on the same rack price basis as sales to distributors and franchised dealers. The Retail Division is responsible for meeting all of its operating expenses and obligations and is expected to provide earnings to the company. As previously indicated, the Retail Division is responsible for gasoline sold through employee operated stores, independent convenience food stores, and franchised retail dealers.

Franchised dealers are charged a transportation fee based upon published common carrier tariffs. This fee is required because the company must deliver the gasoline to its retailers (distributors pick-up at the terminal) due to the fact that the company is responsible for the quality (lead content, octane rating, etc.) of the gasoline until it is actually delivered to the retail outlet. Franchised dealers also pay a franchise fee. This fee covers the various branded marketing services, including national brand advertising, provided by the company.

Real Estate

Retailers occupying marketing facilities owned or leased by Cities Service are charged a monthly rental based upon an independent appraisal of the fair market value of the facilities. Historically, Cities Service's Quik Mart stores have shown a larger return on appraised value than the rent charged to CITGO dealers. This fact is further proof that employee operated Quik Mart stores are not indirectly "subsidized" by the company even though the transfer price of gasoline for Quik Marts is the same as the CITGO dealers base price.

The most significant aspect of Cities Service's real estate policy is the wide range of options available to the CITGO dealer. The CITGO retailer can lease the property (based upon a market-value rental outlined above) and sell unbranded or another major brand of gasoline rather than or in addition to CITGO gasoline so long as the consumer is not confused or deceived. The dealer can even lease the property and use it for any other lawful business. The choice is his.

Finally, the CITGO dealer who prefers not to lease the facility may purchase it if he wants to at its appraised value. Moreover as a matter of practice, the dealer has the first call on the company's marketing facilities when a decision is made to dispose of a particular facility.

Opposition To Legislation Mandating Similar Policies

Although Cities Service has initiated "progressive" retail marketing policies, the company does not support legislation which would mandate similar policies for all refiners. The bases for this objection are as follows. First, while these policies have been successful for Cities Service, they may not be appropriate to the circumstances of other refiners faced with different marketing problems and differing marketing strategies. Second, while Cities Service has initiated similar programs, the marketing flexibility which permitted Cities to experiment in this regard would be lost if federal legislation imposed a broad set of rigid requirements on gasoline marketing. The loss of such flexability may prevent the company from responding to future changes in market conditions. Third, there is no assurance that Cities Service's voluntarily initiated policies would satisfy the specific requirements of any federal legislation mandating particular actions. Fourth, even if no substantive changes are required in the company's marketing practices, any federal legislation will contain burdensome reporting requirements and enforcement risks not encountered by Cities Service under its voluntary programs.

VII. DIVORCEMENT IS UNWARRANTED IN LIGHT OF OTHER PROTECTIONS

In addition to believing that the provisions of S. 326 (other than divorcement) are not warranted and should not be mandated for all refiners, Cities Service believes that retail gasoline marketing divorcement is especially unwarranted in view of the adequacy of the extensive protections which branded retail gasoline dealers already enjoy under other federal laws, especially the Petroleum Marketing Practices Act.

Petroleum Marketing Practices Act

Title I of the Petroleum Marketing Practices Act (PMPA), sometimes called "Dealer-Day in Court," establishes protection for gasoline retailers from arbitrary or discriminatory termination or non-renewal of their leases and supply agreements. The PMPA prohibits a supplier from terminating a supply relationship with a branded dealer during the term of the lease and/or supply agreement and from failing to renew the relationship at the expiration of the lease and/or supply agreement unless that termination or non-renewal is permitted under the Act.

Even where a permitted grounds for termination or non-renewal exists, generally a refiner must give the branded retail marketer 90 days notice. Where the basis for termination or non-renewal is the withdrawal of the refiner from marketing of motor fuels in a market area, six months advance notice of termination or non-renewal is required.

Under the PMPA, the legislative grounds for termination or non-renewal are narrowly prescribed. Thus, for example, while a branded retailer may be terminated for failure to comply with a provision of his lease and/or supply agreement, termination or non-renewal is permitted only if the violated provision is both reasonable and of material significance to the relationship between the retailer and his supplier. That is to say not every violation of a provision of a contract between the retailer and his supplier gives rise to a right of termination under the PMPA. Under the PMPA, violation of contractual provisions which impose unreasonable limitations upon the actions of the retailer or which are not of material significance to the relationship between the retailer and the supplier cannot be enforced through termination of the retailer. Other narrowly defined grounds for termination and/or non-renewal are:

- Fraud or criminal misconduct by the dealer but only if relevant to the operation of the retail outlet;
- Bankruptcy or insolvency of the retailer, but only if judicially declared;
- Continuing severe physical or mental disability of the retailer but only if of at least three months duration and only if the disability renders the retailer unable to provide for the continued proper operation of the retail marketing facilities;
- Condemnation of the retail marketing facilities through the power of eminent domain;
- Destruction of all or a substantial part of the retail marketing facilities;
- Adulteration, mislabeling or misbranding or motor fuels by the retailer but only if willful;
- Failure of the retailer to comply with federal, state or local laws or regulations but only if the regulations pertain to the operation of the retail marketing facilities and only if the retailer's failure to comply was knowing;
- Conviction of the retailer of a felony but only if the felony involves moral terpitude.

To protect retailers from retaliatory actions by a supplier, under the PMPA a supplier is not permitted to base termination or non-renewal upon old and long forgotten events. If the supplier fails to exercise his termination or non-renewal rights based upon a specific event within the period of time permitted under the Act, the supplier may not thereafter base termination or non-renewal upon the same event. In addition, for certain grounds, termination or non-renewal is not permitted unless the retailer has been notified of the failures and afforded an opportunity to cure these failures.

Although the PMPA does permit termination and/or non-renewal based upon certain economic considerations, these grounds are narrowly circumscribed and prevent a refiner from terminating or failing to renew for the purpose of converting a retail outlet to employee operation.

An important side effect of the PMPA has been the development of the practice by refiners of offering long-term leases and supply agreements to their retailers. This practice has been encouraged by the provisions of the PMPA which grant suppliers increased flexibility with respect to non-renewal of leases and/or supply agreements where the term of the lease and/or supply agreement is three years or longer.

The PMPA also gives to retailers significant protection where the supplier terminates or fails to renew on the basis of withdrawal from the market area. In such cases, the retailer must be granted either a right of first refusal of any third party offer to purchase the service station facilities leased by the retailer or, if the supplier proposes to sell his interest in the outlet to a third person as part of a block sale, the acquiring party must offer the retailer a lease and/or supply agreement which does not discriminate against the retailer.

A supplier who terminates or fails to renew a lease and/or supply agreement in violation of the requirements of the PMPA is subject to judicial enforcement action. In particular, federal district courts are authorized to issue an injunction against the offending supplier mandating reinstatement of the retailer. Importantly, in any such judicial enforcement proceeding, the burden of proof is placed upon the supplier to document the validity of the claimed grounds for termination or non-renewal. In addition, a liberal standard for the grant of preliminary injunctive relief virtually assures that the retailer will be protected from termination and/or non-renewal until after the supplier has proved the validity of the claimed grounds for termination and/or non-renewal.

In addition to injunctive relief preventing a supplier from improperly terminating or failing to renew, the PMPA authorizes the retailer to collect actual damages and, if the supplier's actions were in willful disregard of the requirements of the PMPA, the retailer can collect exemplary or punitive damages. Also, where the retailer prevails, the PMPA authorizes payment of reasonable attorney and expert witness fees by the supplier.

The foregoing summary illustrates the substantial protections afforded retail gasoline marketers under the PMPA from arbitrary or discriminatory termination and/or non-renewal by their supplier.

Federal Antitrust Laws

In addition to the substantial protections enjoyed by branded retail gasoline marketers under the Petroleum Marketing Practices Act, federal antitrust statutes provide protections against unfair competition and discriminatory pricing practices.

Section 5 of the Federal Trade Commission Act (15 U.S.C. §45) provides:

> Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.

The Federal Trade Commission is authorized to investigate complaints of unfair competition. If the Commission finds that any person has engaged in unfair methods of competition or unfair or deceptive acts or practices, the Commission is authorized to order the party to cease and desist from engaging in the prohibited acts or practices.

The Robinson-Patman Act (section two of the Clayton Act of 1914, as amended by section two of the Robinson-Patman Act of 1936, 15 U.S.C. §13) prohibits price discrimination in the sale of commodities in interstate commerce. The Act provides:

> It shall be unlawful for any person engaged in commerce . . . to discriminate in price between different purchasers of commodities of like grade and quality . . . where the

> effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition . . . provided, that nothing . . . shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are . . . sold or delivered . . . .

In Danko v. Shell Oil Co., 115 F.Supp. 886 (E.D.N.Y. 1953), the court sustained a complaint against the defendant Shell Oil Company for granting preferential treatment to gas stations owned "directly or indirectly" by it. The court stated that the fact of such ownership "would not destroy the relationship of vendor and purchaser." 115 F.Supp. at 888.

More recently, in Mississippi Petroleum, Inc. v. Vermont Gas Systems, Inc., 1972 Trade Cases ¶73,843 (S.D. Miss. 1972), the court brushed aside the contention of Vermont Gas Systems, Inc., that transfers of gasoline to its operated stations were mere bookkeeping entries. The court stated, "It is immaterial what the transaction is called if the stations are competitive . . . . [I]f a manufacturer sells to buyers, who are competitors, he must treat them equally." Id. at 91,534-5.

Vigorous enforcement of federal antitrust laws should assure independent gasoline retailers of adequate protections against both unfair competition and discriminatory pricing practices. No further federal legislation is required particularly if that legislation would be anticompetitive and tip the balance from free competition, which benefits consumers, to protectionism which increases consumer prices.

VIII. CONSUMER COST OF DIVORCEMENT

A further ground for Cities Service opposition to divorcement is the unacceptable consumer cost of such legislation. During an inflationary period, Cities Service believes the Congress should exercise care to assure that consumer costs of an essential commodity, such as gasoline, are not unnecessarily increased by elimination of competition in order to subsidize a particular class of marketers. The conclusion that divorcement would increase the pump price of gasoline to the motorist is supported by a market study of the consequences of divorcement in Maryland.

Cities Service's Study Of Divorcement In Maryland

Cities Service has performed an analysis of the effects of divorcement in Maryland based upon comparison of gasoline pump prices in Maryland with those in Richmond, Virginia, and Atlanta, Georgia.

Until recently, Cities Service was in litigation with the State of Maryland regarding that state's divorcement law and, pending the outcome of that litigation, the courts had permitted Cities Service to continue its direct retail marketing operations. Unlike most refiners, therefore, Cities Service had an opportunity to monitor on a regular basis the posted pump prices in Maryland.

Cities Service also has direct retail operations in the Richmond, Virginia, and Atlanta, Georgia, markets. These markets possess many characteristics similar to those of the Maryland markets in which Cities Service operated, with the notable exception that refiner operated outlets are permitted to operate in the Richmond and Atlanta markets but not generally in Maryland. These characteristics led Cities Service to conclude that Richmond and Atlanta provided a valid basis for comparison of the consumer impact of Maryland's divorcement legislation.

At the outset, it should be noted that the data utilized for this analysis was not collected for that purpose. The pump price observations were gathered as a part of an "in-company" routine market survey utilized for pricing purposes. After the fact, it became apparent that this data could be utilized to indicate the consumer cost impact of divorcement.

Observed pump prices were adjusted by elimination of state and local taxes. A similar adjustment was made to reflect differences in transportation costs between the Atlanta and Richmond markets on the one hand and the Maryland market on the other. More specifically, the Colonial Pipeline Tariff for gasoline transported to Atlanta or Richmond, as the case may be, was subtracted from the Colonial Pipeline Tariff for transportation of gasoline to terminals serving Maryland. The increased cost of transportation to Maryland was added to the observed gasoline prices for Richmond and Atlanta. To the extent that Maryland suppliers do not experience the full amount of this cost disadvantage, the methodology utilized by Cities Service understates the cost impact of divorcement.

The prices utilized in the Cities Service survey were not weighted by volume. In addition, the pump prices utilized in this survey do not include Cities Service's own prices.

In Maryland the pump prices of approximately 124 competitors of the company's employee operated retail outlets were observed. In Richmond the pump prices of approximately 29 competitors were observed. In Atlanta the pump prices of approximately 93 competitors were observed. As previously indicated, to ensure an unbiased analysis, no CITGO prices were included.

In Maryland, 18% of the stations surveyed were full service. The remaining 82% were self service or "split island" (combined full service and self service) stations. At the split island stations, however, only self service prices were surveyed since typically these are the prices "posted" prominently by the dealer. "Major brand" stations comprised 66% of the Maryland survey, with the remainder comprised of independent and non-major brands. For this purpose, "major brand" stations are those of Amoco, Arco, Chevron, Exxon, Gulf, Mobil, Shell and Texaco.

In Richmond, Virginia, 7% of the surveyed stations were full service; 93% were self service or split island. Again, only self service prices at split island stations were surveyed. Major brand stations comprised 50% of the sample; the remaining 50% were independent and non-major brand stations.

In Atlanta, Georgia, 13% of the surveyed stations were full service; 87% were self service or split island (only self service prices were surveyed at split island stations, however). Major brand stations comprised 44% of the sample; independent and non-major brand stations comprised the remaining 56%.

Results of Cities Service's Price Study

The results of this survey are presented graphically on the following charts (Figures 4 and 5). The lightly shaded bar represents regular gasoline; the heavily shaded bar represents unleaded gasoline. The charts indicate the excess of the retail gasoline price in Maryland (expressed in cents/gallon) over the retail price of gasoline in Richmond and Atlanta. The results of the survey indicate that, in every quarter, the consumer in Maryland paid from 1 cent to 4.5 cents more than the consumer in Atlanta or Richmond. On a national basis, such a price differential translates into a consumer cost of divorcement of between $1.0 and $4.5 billion per year.

FIGURE 4

DIVORCEMENT COST
TO CONSUMER
(MARYLAND VS. ATLANTA)

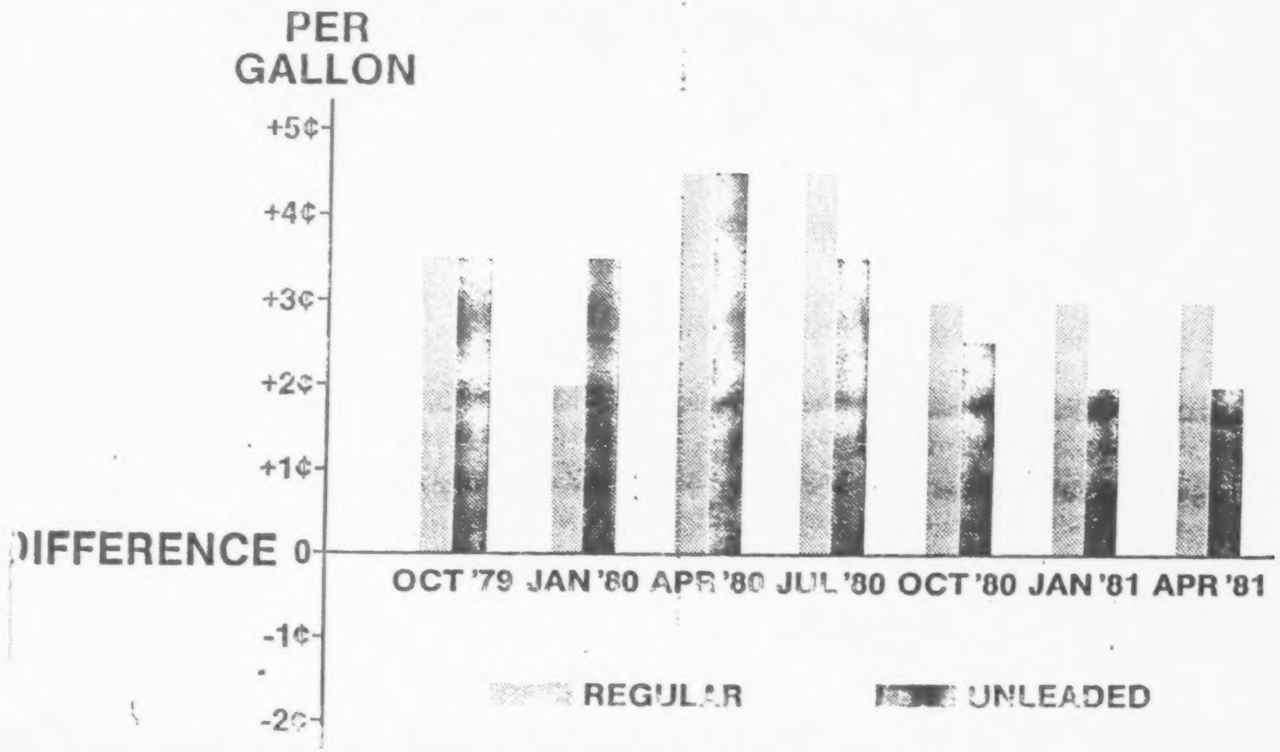
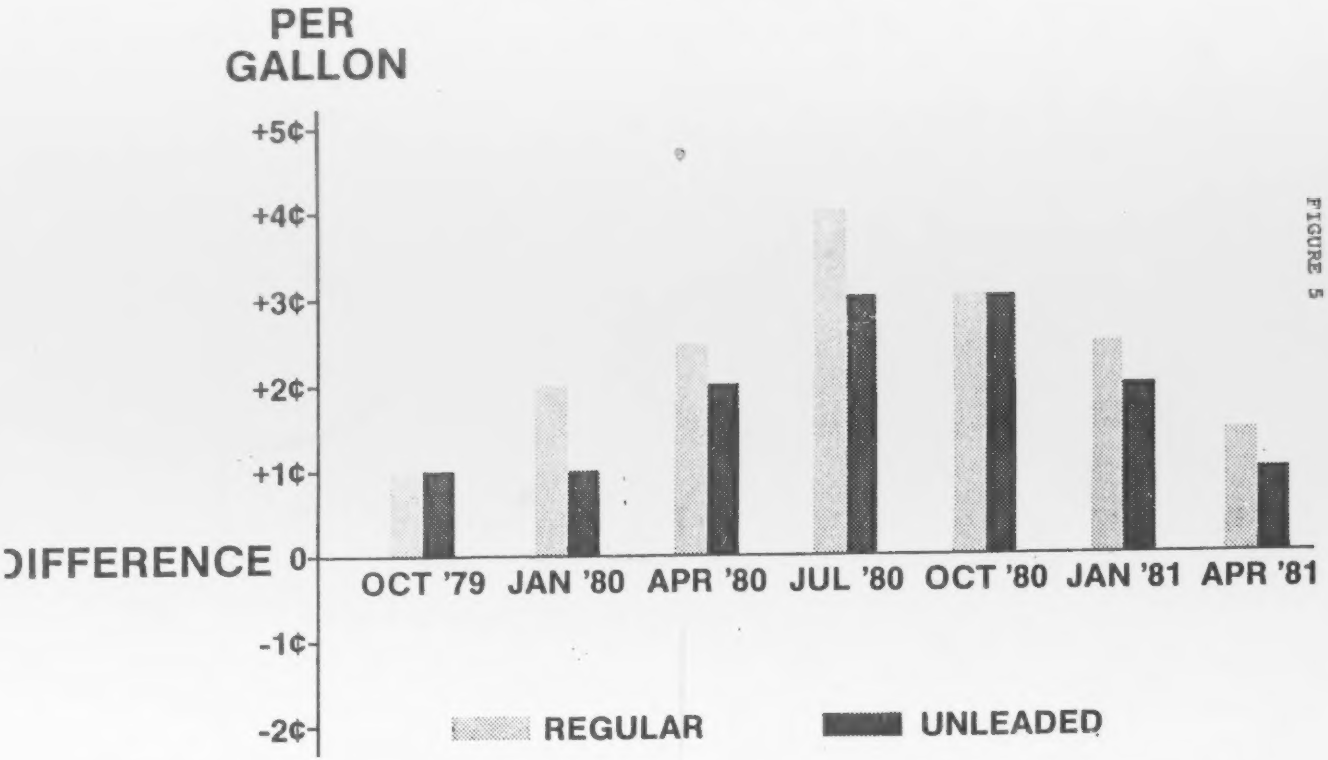


FIGURE 5

DIVORCEMENT COST
TO CONSUMER
(MARYLAND VS. RICHMOND)



IX. MISCONCEPTIONS ABOUT DIVORCEMENT

Cities Service believes divorcement is a misdirected attempt to solve a problem deeply rooted in the economics of gasoline retailing. As such it is doomed to failure.

Nevertheless, due to pervasive misconceptions about the causes of the economic problems of gasoline retailers and even more fundamental misconceptions about the effects of the purported cure, the proposal to divorce major refiners from direct retail sales of gasoline continues to find credence among those searching for a political answer to a complex economic issue. Cities Service believes the myths surrounding divorcement are eliminated by the responses to the following series of questions:

Q. Isn't it true that Divorcement is needed to protect franchised gasoline dealers from being terminated by their refiner-suppliers in order that the refiner can convert the station to employee operation?

A. No. The Petroleum Marketing Practices Act (PMPA), a federal statute enacted in 1977, limits the grounds on which a franchised dealer may be terminated. The PMPA bars termination of a dealer merely because the refiner desires to convert a station to employee operation. Federal district courts are empowered to enjoin such terminations.

Q. Well, isn't it true that in fact large numbers of dealers have gone out of business during the past few years while the number of employee operated stations of refiners has increased? Isn't Divorcement needed to halt this trend?

A. That is incorrect. During the period 1972-1978 the number of major brand lessee dealer stations declined by nearly 47,000 units while the number of employee operated outlets of the 16 largest refiners increased by only 235 units. The total number of employee operated stations of major refiners (approximately 8,500) remained a small fraction of their total number of outlets (approximately 115,000). The facts simply don't support the conclusion that refiners have been expanding their employee operated retail outlets to the detriment of lessee dealers.

Q. Well, if dealer operated stations were not being converted to employee operated outlets by refiners, what accounts for the decline in the number of lessee dealer stations?

A. No single cause, and certainly not conversion to employee operation, accounts for this decline. While many factors contributed to the decline, two principal causes for it may be identified:

(1) changing consumer preferences; and

(2) federal price and allocation rules which prevented dealers from responding to changing market conditions.

Q. What do you mean "changing consumer preferences?"

A. During the 1960's and early 1970's, lessee dealers made a living from a combination of gasoline sales, sales of tires, batteries and automotive accessories (TBA), and automobile service work. During this period low volume outlets were the norm and full service was demanded by the need to constantly check oil coolant and battery fluid levels as well as belts, hoses and tire wear.

Then three developments combined to threaten the economic viability of full service, low volume lessee dealer stations. First, technology conspired against the lessee dealer. As the complexity of automobiles increased during the 1970's, more and more of the routine service work on new cars was performed by new, well equipped service departments of new car dealers. Radial-ply tires replaced the old bias-ply tire and lasted three or four times longer. As the price of a replacement set of tires rose, consumers began to purchase replacement tires from specialty shops. Sealed cooling systems, sealed batteries and long-life motor oils reduced the need for routine service.

Second, new competitors entered the market, taking away much of the service and TBA sales previously enjoyed by service station dealers. Specialty tune-up shops, AAMCO transmission shops, Midas muffler shops, etc., cut into the dealer's service work.

Finally, the unprecedented increase in gasoline prices during the period following the 1973 Arab oil embargo made consumers more price conscious. No longer requiring the services provided by a full service station, and their brand loyalty shaken by the realities of periodic shortages, consumers began to shop for cheaper gasoline. High volume, self service stations enjoyed an advantage by being able to operate on lower per gallon margins.

Q. So why didn't lessee dealers simply convert from low volume, full service stations to high volume, self service operations?

A. Easier said than done. First, not all the low volume stations could convert to high volume outlets. Gasoline demand did not grow fast enough to support the same number of high volume stations as were previously low volume stations--indeed since 1978 overall gasoline demand has declined steadily. Second, DOE regulations prevented many lessee dealers from adjusting to the new realities of the marketplace. These dealers remained locked into allocation levels based upon 1972 sales.

Q. O.K. If employee operated outlets of refiners did not grow in number and the number of lessee dealer operated stations declined, who sold the gasoline?

A. Middle men called gasoline jobbers and chain marketers who sometimes supply branded lessee dealers but who also often operate their own stations. Market share data indicates the following:

	MARKET SHARE	
Type of Sales	1972	1979
Refiner direct sales	16.2%	16.7%
Dealer sales	50.7%	36.9%
Independent and jobber sales	33.0%	46.3%

Q. It certainly looks like jobber and chain marketer sales increased at the expense of dealer sales.

A. Precisely; and divorcement (S. 326) does nothing about this trend because it applies only to major refiners.

Q. Are you suggesting divorcement won't help the dealer because it is not directed at the real cause of the dealer's problem?

A. You bet.

Q. But even if it doesn't help, it can't hurt, can it?

A. To the contrary, enactment of S. 326 would be very bad. The legislation doesn't merely stop the growth of refiner operated stations--it forces refiners to close, sell, or convert the outlets they currently operate. In conjunction with other aspects of the bill, this requirement of the legislation is anticompetitive.

Q. What do you mean "anticompetitive"?

A. Employee operated stations of refiners are typically high volume price competitive stations. Once these stations are closed, the remaining stations in the area will be able to raise their prices and increase their margins.

Q. But the refiner can still sell its gasoline at wholesale. So what if the dealers who are pushing for this bill increase their margins?

A. Tell that to the consumer who will pay more for his gasoline. Based upon the experience with divorcement in Maryland, enactment of divorcement at the federal level could cost consumers billions of dollars annually. That's unnecessary pressure on inflation and too high a price for the consumers of this country to pay for special interest legislation.

The foregoing questions and answers also provide an accurate summary of Cities Service's objections to S. 326.

X. SUMMARY CONCLUSION

Cities Service is a vertically integrated refiner which markets gasoline under the CITGO brand through lessee dealer operated and employee operated retail outlets. Cities Service would be directly affected by retail gasoline marketing divorcement. Indeed, because of the importance of its employee operated "Quik Mart" stores to its gasoline marketing strategy, divorcement would harm Cities Service more than most of its larger competitors.

Divorcement legislation is a political response to the decline in number and market share of retail gasoline marketers. It is based upon the mistaken belief that this decline is attributable to the predatory growth of direct retail marketing operations by major refiners.

In reality the decline in the number of retail gasoline marketers is the result of changing market conditions brought about by major changes in automotive technology, oil supply interruptions, rapid gasoline price increases, increased price sensitivity of consumers and reduced gasoline demand. The trend in gasoline marketing, as in other forms of retailing, is toward fewer retail outlets and greater volumes per outlet.

The federal regulatory system of price and allocation controls also contributed to the demise of gasoline retailers by preventing existing retailers from converting low volume outlets, dependent upon declining sales of automobile services and accessories, to high volume gas only outlets. Unable to adjust to changing conditions many retailers were forced from the market.

An in-depth Congressionally-mandated study of gasoline marketing performed by the DOE confirmed:

- o There has not been a massive movement by refiners into the direct retailing of gasoline.
- o No evidence was found of a predatory pricing campaign by refiners.
- o The decline in the number of retail dealers was due to changing economic and marketing conditions.
- o This decline was aggravated by federal price and allocation controls.

Market forces, rather than a predatory growth of direct retail marketing operations by major refiners, are at the core of the decline in the number of retail gasoline marketers. Divorcement will not stem this decline.

Whether divorcement can succeed in protecting gasoline retailers from the forces of change which they fear is doubtful. What is certain is that divorcement will reduce competition and increase the retail price of gasoline paid by the consumer; it is anti-consumer, special interest legislation in its worst form.

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202/466-7640

2500 TRUST COMPANY TOWER
ATLANTA, GEORGIA 30303
404/572-4600

October 21, 1981

BY HAND

Mr. Charles J. DiBona
President
American Petroleum Institute
2101 L Street, N.W.
Washington, D. C. 20037

Re: S. 326

Dear Charlie:

During the course of my testimony today before the Senate Judiciary Committee on S. 326, Senator Thurmond asked for my views on alternatives short of federal legislation which might resolve the alleged economic difficulties apparently confronted by some independent dealers.

I responded that federal legislation would, in my opinion, result in unnecessary federal preemption of an area more properly left to the states. In any event, I suggested that the questions at issue could best be addressed by the major oil companies through their voluntary adoption of policies and principles ensuring fairness in their transactions with independent dealers. Such an approach would prevent the recurrence of those isolated instances of unfair dealing to which some independent dealers have testified. It would also avoid unnecessary, unworkable, and expensive federal regulation. I also mentioned that such policies might then be incorporated as agreed standards of conduct in contracts between the independent dealers and oil companies with the accompanying provision that subsequent violations could be arbitrated in an appropriate forum to avoid expensive, time consuming litigation.

Senator Thurmond then asked me to consult with him as soon as possible and in any event within sixty days regarding the particular policies which the oil companies would voluntarily adopt as a matter of internal policy. I in turn informed him that while the American Petroleum Institute represents in excess of 8,000 different companies I would undertake to inform you immediately of the substance of our dialogue so that you could begin immediate consideration of those types of workable policies which could be implemented to ensure fair dealing on all sides.

I am therefore writing both to inform you of my conversation with Senator Thurmond and to request your thoughts and suggestions in this regard. While I made it clear to Senator Thurmond that the views which I expressed were my own, I do think that this approach might be workable and will avoid the unnecessary complexities, ambiguities, and inequities of the proposed legislation. I would therefore appreciate your thoughts since I have an obligation to consult with Senator Thurmond on this subject.

Best regards.

Sincerely yours,

Griffin Bell

Griffin B. Bell

GBB/pw

cc: The Honorable Strom Thurmond

KING & SPALDING
2500 TRUST COMPANY TOWER
ATLANTA, GEORGIA 30303
404/572-4600

1800 M STREET, N. W.
WASHINGTON, D. C. 20036
202/466-7640

November 3, 1981

Honorable Strom Thurmond
United States Senator
Washington, D. C.

Dear Senator Thurmond:

I enclose a copy of a letter received from Mr. DiBona, President of the American Petroleum Institute in response to my letter to him of October 21 concerning some fair trade practices approach to the dealer problem which you have under consideration in S. 326.

Mr. DiBona sent you a copy of this letter but I am sending another copy as a cautionary measure.

I will keep you advised. Warm wishes.

Sincerely,

Griffin Bell

Griffin B. Bell

GBB:fc
Encl.

TELEX: 54-2917 TELECOPIER: 404/659-4838 CABLE: TERMINUS

American Petroleum Institute
2101 L Street, Northwest
Washington, D. C. 20037
202-457-7300

Charles J. DiBona
President

October 27, 1981

The Honorable
Griffin B. Bell
2501 M Street, NW
Suite 500
Washington, D. C. 20037

Dear Judge Bell:

Thank you for your letter of October 21 concerning your testimony before the Senate Judiciary Committee in opposition to S.326, and the request by Senator Thurmond for your views, short of federal legislation, which might resolve perceived economic difficulties facing some independent dealers.

Let me assure you that this matter will be brought to the attention of the appropriate industry people as soon as practicable and that I will communicate with you immediately thereafter.

We appreciate your interest and assistance in this matter.

Sincerely,

cc: The Honorable
Strom Thurmond
United States Senate

KING & SPALDING
2501 M STREET, N. W., SUITE 500
WASHINGTON, D. C. 20037
202/466-7640

2500 TRUST COMPANY TOWER
ATLANTA, GEORGIA 30303
404/572-4600

November 16, 1981

BY HAND

The Honorable Strom Thurmond
Chairman, Committee on the Judiciary
United States Senate
209 Russell Senate Office Building
Washington, DC 20510

Re: S. 326

Dear Senator Thurmond:

You will recall that when I testified in opposition to Senate Bill 326 on October 21, you and I discussed the possibility of an industry statement of principles which might give some assurance to the independent petroleum dealers and render Senate Bill 326 unnecessary. Although I have not had the 60 days which I had hoped to have to try to produce an industry statement of principles, I am enclosing a letter from Charles J. DiBona, President of the American Petroleum Institute, which I trust will be helpful.

I continue to believe strongly that Senate Bill 326 is overreaching, that it would not cure the ills alleged by the independent dealers, that its enactment would be most unwise, and that this matter is best addressed by the individual states instead of through preemptive federal legislation. I hope the principles set forth in Mr. DiBona's letter will give you and other members of the Committee sufficient confidence in the intentions of the major refiners, so that the draconian effects of Senate Bill 326 can be avoided.

Please let me know if there is anything further I can do to be of help to the Committee.

Yours very truly,

Griffin B. Bell

GBB:fs
Enclosure

American Petroleum Institute
2101 L Street, Northwest
Washington, D.C. 20037
(202) 457-7300

Charles J. DiBona
President

November 16, 1981

The Honorable
Griffin B. Bell
2501 M Street, N.W.
Suite 500
Washington, D.C. 20037

Dear Judge Bell:

This is in further response to your letter of October 21 concerning S.326 and our handling of your request.

Many of our member companies have established dealer relations policies which they publish and update from time to time. These policies contain major safeguards for the dealer. It is also important to note that a large number of our member companies have selected the Refiner/Dealer arrangement as the most efficient method of marketing gasoline. Therefore, it is to their advantage to maintain the best possible relationship with their dealers.

Under this system of marketing, the public has benefited as has the dealer. It is true that gasoline marketing has undergone significant changes over the past few years. These changes are responses to the public's desires. There is very little credible evidence of dealer abuse during this transition. In those isolated cases of alleged mistreatment, I believe our members have acted promptly to correct the situation.

It is the policy of the American Petroleum Institute member companies to conduct business activities and transactions with integrity and fairness and in accordance with ethical and legal standards. Consistent with that policy, the Institute recommends that its member companies adhere to the following policies with regard to their commercial relationships with their branded lessee dealers in the retail sale and distribution of motor gasoline:

All business shall be conducted in accordance with the antitrust laws of the United States of America and the policies of free and unrestricted competition which those laws are intended to promote.

All business shall be conducted in accordance with the Petroleum Marketing Practices Act of 1978 (PMPA) and all other applicable state and federal laws addressing the relationship between supplier companies and their dealers. The PMPA requires the supplier to act in good faith when a lease is terminated; prescribes conditions under which leases may be terminated; and specifically prohibits terminations which are arbitrary or not based on good cause. In addition the dealer is afforded a "right of first refusal" in the event the lease is not renewed because the station is to be sold.

Suppliers shall communicate in good faith with dealers when problems arise in an attempt to resolve such problems in a mutually satisfactory manner when it is possible to do so.

I would be pleased to discuss this further with you and/or Senator Thurmond at any time.

Sincerely,

(21)

CORPORATE SECRETARY'S
OFFICE
NOV 2 1981

DLB		CCS	
LRS			
KJC		TEO	
JCC		DAK	
RAF		FILE	

VICE PRESIDENT LEGAL

NEW YORK STATE DEPARTMENT OF LAW
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ROBERT ABRAMS
ATTORNEY GENERAL

DAVID A. SMITH
ASSISTANT ATTORNEY GENERAL IN CHARGE

October 26, 1981

NO: 1 2 '81

JWM

Counsel's Office
Shell Oil Company
50 West 50th Street
New York, New York

Dear Sir or Madam:

This office has been conducting an investigation pursuant to Executive Law §63 (12) and General Business Law §349 relative to the sale of "off brand" gasoline at "name brand" stations. By "name brand", we mean those which operate under the name of your corporation or that of any major oil company. The investigation began as a result of several inquiries to this office regarding the legality of such practices.

Our initial investigation seems to indicate that the practice in question is quite pervasive throughout Long Island. Moreover, the prices charged for the apparently "off brand" gasoline appear substantially higher than they would be if the gasoline were labelled properly and people knew what they were actually purchasing.

This office believes that it constitutes a consumer fraud and/or a deceptive business practice, as defined by the aforementioned New York statutes, for "off brand" gasoline to be sold under a name brand. Regardless of whether or not there is a close similarity in octane ratings, that alone would appear to be totally insufficient as a justification for such a practice. Your company, like all the major oil companies, goes to great lengths in its advertising to convince the public of the superiority of your gasolines. Once this impression has been created, the public has a clear right to get what they have been made to believe they are getting when they pull up to a pump bearing your corporate insignia.

We are aware of the fact that a large percentage of the gas stations bearing your corporate name are independently owned and operated. Nevertheless, the problem is one that intimately involves your company, as it is your product that consumers believe they are buying and which your advertising leads them to believe is superior. In order to enable us to further understand the gasoline distribution system on Long Island, and the nature and extent of your corporation's contact with and control over gas stations which carry your corporate name, I would ask that you contact me at your earliest convenience to arrange a meeting in this office at a mutually convenient time.

Thank you for your anticipated cooperation.

Very truly yours,

DAVID A. SMITH
Assistant Attorney General
In Charge

DAS:pp

S. C. OIL JOBBERS ASSOCIATION
P. O. Box 64
COLUMBIA, S. C. 29202

WHERE HAVE ALL THE STATIONS GONE - AND WHY?

Service station population figures over the last few years show some startling changes!

In the '50s and '60s, they were springing up on every corner, as the battle raged for the customer's dollar In the peak year of 1972, there were 226,459 gasoline and service outlets in the US - one for every 400 cars.

Today, only 158,000 remain, and predictions are that by 1983, only about 125,000 will be left - with more closings to come.

WHY HAS THIS HAPPENED - when there are more automobiles to be serviced than ever before - and more customers to be served?

The automatic reaction is to say that "someone" is putting the dealer out of business - with the finger pointed to the major oil companies and to the jobbers who supply the dealers with gasoline.

THAT SIMPLY IS NOT TRUE.

The simple truth is that it is the customer who is changing his preferences - both in gasoline service and in mechanical service - and the dealer is bearing the brunt of these changes.

In gasoline, high prices have forced the consumer to look for the lowest prices available - and that means self-service, either at pumpers (where high volume lowers the price) or at convenience stores (where other goods carry much of the overhead).

Dealers have been reluctant to change their methods to fit customer demands.

BUT GASOLINE IS NOT THE ONLY CULPRIT! WHAT ABOUT REPAIR SERVICE AND ACCESSORIES?

Dealers have seen much of the service business they depended on shift to a variety of new marketers - including major retail stores, automotive parts chains, specialty service centers, retail tire outlets - and even to the back-yard of the customer, where he "does it himself."

> Cars themselves began to require fewer tires, oil changes and other services routinely performed at service stations. Meanwhile, their increased complexity called for more equipment and highly skilled mechanics than small stations could afford.
>
> Extended warranties on new cars channelled repair work back to the new-car dealer.
>
> Specialized requirements of foreign cars meant that most of them went back to the dealer for service, even after the warranty period had expired.

The list of services once the domain of the full-service station *BUT NOW FOUND ELSEWHERE* is a long one -

- *General repairs (including computerized tune-ups)*
- *Lubrication (Kwik-Lube Shops and "do-it-yourselfers")*
- *Tire service*
- *Battery service*
- *Accessory sales*
- *Car wash*
- *Muffler and tail pipe service and replacement*
- *Air conditioner service*
- *New car service (after the warranty period)*
- *Foreign car service*

These are profit centers which are not related to gasoline sales, but which once provided a good income for the full-service dealer.

WHERE DOES IT ALL LEAD?

- to the inevitable conclusion that a law prohibiting the operation of retail service stations by major oil companies - and other suppliers of petroleum products - will *NOT* solve the problems of the dealers.
- The dealers will continue to lose their service business to other markets - unless they conform to the demands of their customers.

IS THE CONSUMER BEING HURT BY THESE CHANGES?

As a matter of fact, the consumer is getting the benefit of lower gasoline prices by pumping it himself. The highest prices in the Nation are at the self-service islands of *full-service stations*. The next highest are at the *full-service stations* themselves.

And the motorist is probably getting better service on his car today than ever before.

S.326 - THE SMALL BUSINESS MOTOR FUEL MARKETER PRESERVATION ACT OF 1981 - will not preserve the dealers. It assumes that all their problems are related to gasoline sales. In truth, the troubles being faced by the dealers stem from many sources - *gasoline is only one.*

Before you vote on S.326, ask yourself if such a drastic re-structuring of the industry would solve the problem at hand.

WE BELIEVE IT WOULD NOT!

SOUTH CAROLINA OIL JOBBERS ASSOCIATION
Dick deMontmollin
Executive Director
P.O. Box 64
Columbia, S. C. 29202

CHANGE IN THE RELATIVE SHARE DISTRIBUTION OF CLASS OF TRADE FOR THE 20 PRIMARY MOVERS, BRANDED (INCLUDING PRIMARY AND SECONDARY BRANDS) MARKET ONLY

[In percent]

Primary mover group	Company-operated retail outlets			Lessee dealers, supplied direct			Open dealers, supplied direct			Sales to branded jobbers		
	1972	1978	Change	1972	1978	Change	1972	1978	Change	1972	1978	Change
PM-1	10.1	40.8	+30.7	56.7	24.0	−32.7	16.1	19.7	+3.6	17.1	15.4	−1.7
PM-2	15.6	26.9	+11.3	43.7	28.	−15.7	16.3	13.3	−3.0	24.4	31.7	+7.3
PM-3	10.5	20.5	+10.0	48.3	32.9	−16.6	15.7	10.2	−5.5	25.5	36.5	+11.0
All prime movers	11.6	27.9	+16.3	49.5	29.0	−20.5	16.0	13.7	−2.3	22.8	29.3	+6.5

Note: Completed from data obtained from Table 4-7, page 123, DOE Final Report, The State of Competition in Gasoline Marketing. Submitted by Senator Howard M. Metzenbaum.

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